THE CONCEPT OF "COMPARABILITY" IN THE DIRECT-TAXATION-JURISPRUDENCE OF THE EUROPEAN COURT OF JUSTICE

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A What does "EC law" mean for direct taxation purposes? Defining competence and compliance in the EU legal framework

1. Introduction

At the present stage of development of the European integration process, Community Law has become crucial to the functioning of national legal systems in an impressive number of areas.

The two instruments whereby community law has come to completely reshape national legal frameworks are well known: "supremacy" and "direct effect".

"Supremacy" entails that EC law -which includes the Treaty, the General Principles, secondary legislation and international agreements[1]- is situated at the top level of the hierarchy of norms that operate within the Community and, as such, prevails over incompatible provisions ranked at a lower level, namely domestic law and international (bilateral or multilateral) law[2].

"Direct effect" means that where community law is "*clear, precise and unconditional enough to be considered justiciable*[3] the same may be relied upon by individuals before national courts[4].

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1 Of which the EU is a party to.

2 The fundamental ruling whereby the ECJ affirmed its constitutional theory of Community Law supremacy is ***Costa v ENEL*** **(Case 6/64).**

3 P. Craig – G. De Burca, *EU Law*, Oxford, 2008, 268.

Direct taxation is affected by EC-law in accordance to essentially two patterns of integration: "positive integration" and "negative integration". Whereas the former predicates that the legislative bodies of the Community (the Council and the Commission) take action by laying down secondary legislation that, either directly (through regulations), or indirectly (through directives), dictates as how Member States (also MS) should levy direct taxes, the second relies on the provisions of the Treaty and on the General Principles of EC Law which the MS have undertaken to comply with by joining the Community.

2. Positive integration and competence

Positive integration necessarily presupposes competence, that is to say the "*legal power or ability to take a particular action*"[5].

The legal basis of the Community's competence in the direct tax area is provided essentially by article 94 and art. 96 of the Treaty[6]: under both articles the Council - acting unanimously or by qualified majority respectively- has the power to issue directives in direct tax matters (in fact there is no exclusion thereof). It is well known that, although art. 96[7] has yet never been relied upon, art. 94 is the legal ground onto which the Parent-Subsidiary, Merger, Interest and Royalty, Savings Income, Capital Duties directives stand.

The fact that the Council may act only unanimously under the main integration legal basis (art. 94) and that, as a consequence, each Member State retains a veto right should not be construed as if the Community had no competence in direct taxation[8]; indeed, also art. 93 requests the Council to act unanimously, but this has not stopped

4 The first (and most famous) articulation of the "direct effect doctrine" is contained in the decision in ***van Gend en Loos*** **(Case 26/62).**

5 T. O'Shea, *EU Tax and Double Taxation Conventions,* London, 2008, 76.

6 Article 95 (1) -which provides for qualified majority decisions on matters concerning the establishment and the functioning of the internal market- is not applicable to fiscal provisions [see art. 95 (2)].

7 Under that provision the Commission may consult the Member States concerned when it "*finds that a difference between the provisions laid down by law, regulation or administrative action in Member States is distorting the conditions of competition in the common market and that the resultant distortion needs to be eliminated*". Should such consultation "*not result in an agreement eliminating the distortion in question*", the Commission may prompt the Council to take action by adopting by a qualified majority the "*necessary directives*".

8 As, for instance, implied by statements as the following:- "*The ECJ decisions to date suggest potentially staggering constraints on countries' freedom to resolve what strike us as quintessentially legislative issues-constraints that are fundamentally inconsistent with the fiscal autonomy retained by the member states in their right to veto EU taxing provisions*"*:* M. J. Graetz – A. C. Warren, *Income Tax Discrimination and Political and Economic Integration of Europe,* Yale LJ 2006, vol. 115, 1188.

the same from issuing, for instance, the VAT directives[9]. The only "limit" to the Council's competence in this area is contained in art. 293 which leaves to Member States the initiative to enter into negotiations aimed at the elimination of double taxation within the Community; however, on account of its nature, that provision does not amount to an impediment to the Council if it were to decide to issue directives in such area under articles 93, 94 and 96[10].

In light of the foregoing it can be stated that competence in the EC direct tax area is "shared" between Member States and the Council[11] (even if there are areas in direct taxation where the Community has actually been granted with exclusive competence: an example is the taxation of the EU officials' salaries[12]). By reason of EC law supremacy, to the extent that the Council may exercise its powers, Member

9 There is actually a difference between art. 93 and 94: whereas the latter specifically refers to "*harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation as a mean to ensure the establishment and the functioning of the internal market*", art. 94 refers generically to the "*approximation of such laws regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the common market*". However, there is nothing to support the conclusion that direct taxation does not directly affect the establishment and functioning of the common market and that, as such, it does not fall within the scope of art. 94.

10 F. Vanistendael, *Does the ECJ have the power of interpretation to build a tax system compatible with the fundamental freedoms,* EC Tax Review, 2008, 2, 55. The ECJ, in ***Uberseering*** **(Case Case C-208/00)**, clarified the scope of art. 293 limit with reference to the "mutual recognition of companies" (which is also referred to by that provision) stating that "*Although Article 293 EC gives Member States the opportunity to enter into negotiations with a view, inter alia, to facilitating* (…) *the mutual recognition of companies* (…) *it does so solely 'so far as is necessary' that is to say if the provisions of the Treaty do not enable its objectives to be attained*" (§ 54). According to T. O'Shea, *Id*., 62, if this remark were to be applied to double taxation it would entail that "*the Community and the member States have a responsibility for abolishing double taxation within the Community, because it is an obstacle to the fundamental freedoms. However, in the event of the Community being unable to achieve this objective, the Member States are under a Community obligation to enter into negotiations to secure the benefit of the elimination of this obstacle for the benefit of their nationals within the Community*".

11 Under the doctrine of implied powers the Community may also avail itself with powers that are not explicitly vested in it: by doing so it may further compress MSs' competence in the area where those powers are actually exercised. For an analysis of the ramifications of this doctrine *vis à vis* the competence of MS to conclude double tax conventions with third countries, see T. O'Shea, *Id*., 90 and its comment to *Commission of the European Communities v Council of the European Communities (ERTA),* case 22/70.

12 See the ***Humblet*** **(Case 6/60)** for an early statement of the Community's exclusive competence thereon .

States would be *pari passu* limited in their liberty to exercise their own powers[13].

3. Negative integration and compliance

Negative integration does not necessarily predicate that the Community takes action in the area of law where that integration is sought after. As aforementioned, Member States have undertaken to abide by a body of obligations ever since they joined the Community: and compliance with those obligations -that is to say restraint from the adoption of measures that directly or indirectly result in a violation thereof- is in itself a form of integration among Member States.

These obligations refer essentially to the fundamental freedoms[14], the general principles of EC Law (which include Human Rights)[15] and state aids[16].

13 In situations where the Community is entitled to a "non-exclusive" competence (as in direct-taxation) is must abide by the principle of subsidiarity. To this end art. 5 (2) reads as follows: "*In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the MS and can therefore, by reason of the scale of effects of the proposed action, be better achieved by the Community*". On the dubious meaning of this concept see the opinions quoted in P. Craig-G. De Burca, *Id.*,, 100. For its relevance to direct taxation see T. O'Shea, *Id.*, 19.

14 Free movement of goods (art. 23), free movement of workers (art. 39), right of establishment in relation to self employed workers (art. 43) and companies (art. 48), freedom to provide and receive services (art. 49), free movement of capital (art. 56) and, more recently, the rights of EU citizenship and to move and reside freely within the territory of the member States (art. 17 and 18).

15 The issue of the foundations of these principles has always been a sensitive one for the Court, that has strived to strike a balance between the need to affirm their "autonomy", on the one hand, and to recognize the "inspirational role" played both by the common national traditions and the international human rights agreements (namely the European Convention on Human Rights), on the other.

These balancing efforts are also reflected in the EU Charter of Fundamental Rights (EUCFR) proclaimed by the Parliament, the Commission and the Council in Nice on 7 December 2000. As recognized by the ECJ itself **(*European Parliament v. Council,* case C-540-03)**, the principal aim of the Charter is to "*reaffirm rights as they result, in particular, from the constitutional traditions and international obligations common to the Member States, the Treaty on European Union, the Community Treaties, the ECHR, the Social Charters adopted by the Community and by the Council of Europe and the case-law of the Court …. and of the European Court of Human Rights*".

As a result of the non-ratification of the Constitutional Treaty, which incorporated the entirety of the Charter, the legal status of the latter is not clear. However, although the instrument is not legally binding, the EC institutions nevertheless refer to it as a legal source. The ECJ, in particular, seems to regard the Charter as a solid basis for the development of its case-law on Fundamental Principles and human rights in particular [as testified by the decision in *European Parliament v. Council* referred to above and ***Reynolds Tobacco*** **(Case C-131/03)**].

The gist of this pattern of integration is expressed by the formula that the ECJ adopts at the outset of so many of its judgements in this area:

> "*although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently with Community Law*"[17].

That statement is rehearsed not only with reference to purely domestic tax laws, but also to international agreements - between one Member State and another Member State or between a Member State and a third country (TC) - that *allocate* taxing powers with a view to eliminating double taxation with reference to taxable events that are subject to their overlapping jurisdictions (DTCs): indeed, the Court has made it clear that, although the member States are at liberty

> "*to determine the connecting factors for the purpose of allocating powers of taxation*" (...) "*by means, inter alia, of international agreements*",

once such powers have thereby been allocated, their exercise

General Principles are therefore part of the EU legal framework irrespective of the legal status of the Charter and, as such, they have "direct effect". However, according to the ECJ's case law, General Principles are binding on the MS only "*when they are acting within the scope of application of EC law*" [**(Case 12/86 *Demirel*)** § 28]. When it comes to taxation, it may not always be certain when such a condition is actually satisfied.

To this end it should be kept in mind that the ECJ has consistently held that MS are under the obligation to comply with EC General Principles even in situations where they are entitled to derogate from their compliance obligations with the EC Treaty on account of derogations thereto contained in the Treaty itself **(Case C-260/89 *Ert.*)** or of case-law based imperative requirements in the public interest **(Case C-368/95 *Familiapress*)**.

This seems to entail that the concept of "EC law implementation" also covers those situations where the law that is actually being implemented are the EC Fundamental Freedoms rules within the "negative integration" process (as in *Festersen* Case C-370/05). It follows that domestic provisions -insofar as they engage the Treaty- have to abide by General Principles also in the area of direct taxation.

16 Art. 87 and ff.

17 See for instance decision in ***ACT IV GLO* (Case C-374/04)** § 36.

> "*must comply with Community rules*"[18].

4. The role of the ECJ and of national courts

According to art. 220 of the Treaty the ECJ

> "*shall ensure that in the interpretation and application of this Treaty the law is observed*".

As a consequence of its "supremacy" over national law and its "direct effect", interpretation and enforcement of Community Law is also carried out daily by national courts, which are, therefore, in this respect, "Community courts" in their own merit. Indeed, national courts are the "frontline" interpreters of Community Law and thus actors in the negative integration process, given the number of cases that are continuously dealt with by each of them[19]. Moreover, national Courts have the crucial function to put into operation the interpretation they have requested to the Court (under art. 234) with respect to the main proceedings which has been brought before them[20].

18 ***Gilly* (Case C-336/96)**, §24-30; ***De-Groot* (Case C-385/00)**, §93-94.

With specific reference to DTCs entered into with third Countries, the Court has, to a certain extent, acknowledged that compliance with Community law can disturb "*the balance and reciprocity of a bilateral convention*" and that this may "*constitute an objective justification for the refusal* (...) *to extend to nationals of other member States the advantages which its own nationals derive from that convention*". Nevertheless, such justification has been substantially "outmanoeuvred" by the ECJ, which may authorise a MS not to set aside the "non compliant" DTC, contingent upon the unilateral extension, on its part (that is to say, at its own cost and with no involvement on the part of the third country), of the DTC's tax advantages to all EC nationals that may be entitled thereto pursuant to the Treaty [see ***Saint-Gobain* (Case C- 307/97)**, §59]

19 As pointed out by J.T. Lang, *The Principle of Effective Protection of Community Law Rights*, in *Judicial Review in International Perspective, Liber Amicorum in Honour of Lord Slynn of Hadley*, Kluwer Law International, 2000, 235: - "*One striking feature of the whole Community legal order is the extent to which it relies on national courts to apply Community law*. (…) *The Community depends on national judges. There are only two Community Courts. Community law could not be adequately enforced unless national courts enforce it. Community law is probably now interpreted and applied more often in national courts than in the Courts in Luxembourg. Every national court is a Community law court of general jurisdiction, with the power and the duty to apply every rule of Community law which is relevant to the case coming before it. Since all national courts must apply Community law rather than national law if the two conflict, every national court now has power to review national legislation for compatibility with Community rules: every national court is in that respect a Community constitutional court. Every national court is first and foremost a Community law court, in the sense that its duty to Community law overrides its usual duty to apply national law*".

20 See, for instance, the decision of the UK First Tier Tribunal (available on 2009 WTD 85-22) upon the *Marks & Spencer plc v. David Halsey* ruling

Yet, national-level interpretation lacks of certainty and "accountability" at a Community level: which entails the risk that there might be, at least, as many interpretations of community law as there are Member States of the EU: here lies the crucial function and responsibility of the ECJ, which thus provides a "uniform" interpretation throughout the Community, achieved essentially through the preliminary ruling procedure (art. 234) and the decision of the cases brought to it by the Commission (art. 226).

In this connection, any speculation as to whether the ECJ is or is not consistent in its jurisprudence should be preceded by the preliminary recognition of a basic fact: the ECJ is not a "tax court". In fact the ECJ - in the direct tax area - does not interpret a law that may be labelled as tax law in its own merit[21]. This clearly doesn't mean that the Court's decisions do not have an impact on the Member States' tax legislations and on their DTCs; however, such an impact -which is actually significant- is not necessarily the result of a tax-centred or tax-inspired legal reasoning.

In fact, what the Court currently does is to interpret and subsequently apply EC law with reference to domestic or international tax law, where the term "EC law" refers substantially to the Treaty that, as it is well known, contains essentially non-tax provisions and concepts.

To fully recognize this feature of the ECJ's role in direct tax matters is, in my view, crucial in order to come to terms with its jurisprudence. There is in fact nothing inherently wrong in highlighting that -from a purely domestic or international tax law standpoint- that jurisprudence may be regarded as "inconsistent"[22]; provided that, however, one preliminarily recognizes that such a standpoint is by no means the appropriate one from which to assess whether the Court is or is not standing up to the assignment the ECT has conferred upon it.

B The rationales of compliance assessment

1. Host-State – Origin-State

It has so far been said that compliance entails respect for the fundamental freedoms (plus general principles) and, accordingly, limits the Member States' tax sovereignty

21 Apart when it interprets the direct tax directives. On the contrary one may correctly referrer to the ECJ as a "tax court" when it interprets VAT or Custom duties legislation. On the other hand, the Court's case law in those areas does not determine the same level of discussion among scholars that follows each decision by the ECJ in direct tax matters.

22 Such a charge is extremely common in the EC tax law literature. To a large extent, an epitome thereof may be the authoritative European Tax Law, Kluwer, 2008 of P. Wattel and B. Terra.

irrespective of the Community having or not having exercised its (shared) competence.

This, however, does not describe what compliance actually means or, in other words, when a tax provision may or may not be regarded as compatible with Community Law.

To that end it is in the first place essential to note that compliance may be assessed from two different standpoints, that of the "host-State" and that of the "origin-State".

A Member State may be in a:

i) host-State position when its tax system "interferes" with the exercise -in that Member States- of a fundamental freedom by nationals (individuals or legal entities) of another Member State;

ii) origin-State position when its tax system "interferes" with the exercise by its own nationals (individuals or entities) of a fundamental freedom in another Member State.

It is true that, according to their wording, the provisions on fundamental freedoms seem to be engineered mainly to cover host-State situations; yet the ECJ has consistently held, since the landmark judgement in ***Daily Mail***[23] that "*they also prohibit the Member State of origin from hindering*" the exercise of those freedoms by its own nationals in another Member State[24].

2. Disparities and exercise in parallel by two Member States of their fiscal sovereignty

Before addressing the patterns whereby national tax systems may interfere with the exercise of Treaty-protected rights, a reference should be made to those situations where, according to the ECJ's understanding thereof, there is no interaction between one and the other and, therefore, there is no entitlement to have the adverse effects that stem from those situations removed by the ECJ.

The concept that the Court has expressed in this connection is that the protection afforded by the Treaty through the fundamental freedoms does not entail that, by availing himself with them, an EU national should not -in absolute terms[25]- be worse off than if he had not.

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23 Case 81/87.

24 *Id.,* 16.

25 We shall see below what "absolute terms" actually means.

In the ***Gilly*** case a DTC provided for a foreign tax credit that, on account of the greater progressivity of income taxation in the source-State *vis à vis* the residence-State, would not absorb the whole foreign tax paid by the applicant in the former State. The Court decided that the Treaty gave no protection therefrom because the "disadvantage" was not the result of a national provision that in some way "interfered" with the right of the taxpayer to avail himself with a fundamental freedom (free movement of workers, in this case), but of the higher tax rates of the Member State where that freedom had been exercised[26]. In other words, the Court held that the Treaty gives no guarantee that the "cross border dimension" may be neutral *vis à vis* the domestic one: Member States are entitled to design their tax systems and are therefore under no obligation to "offset" the disadvantages that result from the fact that the internal market is not tax-harmonised.

Interestingly the Court also said that by arguing to the contrary (*id est*: arguing that the origin-State would have had to adjust its foreign tax credit in order to compensate the disadvantage at issue) would amount to "*encroach*(ing) *on* (the Member States') *sovereignty in matters of direct taxation*"[27].

An echo of this logic can also be found in ***Schempp***[28]. The legal background to the case was a domestic provision whereby debtors of maintenance payments were entitled to deduct those payments from their taxable income insofar as the same formed part of the taxable income of the recipient[29]. This provision applied also where the recipient was resident in another Member State[30]. If the recipient had been a resident in the State of residence of the maintenance debtor (Germany) or in a Member State were maintenance payments were taxed, the debtor would have been entitled to deduct the payments[31]. However, the recipient was resident in a Member State (Austria) were these payments were not taxed and, as a result, the deduction thereof was denied.

The Court found that the disadvantage resulting from the fact that the recipient was resident in Austria rather than in Germany was not a consequence of the interplay between the tax system of the origin-State and the Treaty (art. 12, in this case) but of the fact that

26 *Gilly*, §46

27 *Id.,* § 48.

28 Case C-403/03.

29 *Schempp,* § 4

30 *Id.,* § 5

31 *Id.*, § 27 and 33.

> "*the recipient is subject in each of those two cases, as regards taxation of maintenance payments, to a different tax system*"[32].

The decision in the ***Deutsche Shell***[33] case is a more recent instance of the Court's reasoning with respect to disparities. The issue here was that a Member State denied to a resident company the right to deduct a currency loss suffered "*upon repatriation of start up capital granted to its permanent establishment in another Member State*"[34]. Even though the Court concluded that that denial amounted to a violation of the Treaty because it - in itself - restricted freedom of establishment, it incidentally pointed out that, as a rule, such freedom

> "*cannot be understood as meaning that a Member State is required to draw up its tax rules on the basis of those in another Member State in order to ensure, in all circumstances, taxation which removes any disparities arising from national tax rules, given that the decision made by a company as to the establishment of commercial structures abroad may be to the company's advantage or not, according to circumstances*"[35]

To understand the limits to the scope of the protection afforded by the Treaty to taxpayers a reference must also be made to the issue of the exercise in parallel by two Member States of their fiscal sovereignty and to the juridical double taxation that may result from it.

The Court has consistently pointed out that

> *"in the absence of unifying or harmonising measures adopted by the Community, the Member States remain competent to determine the criteria for taxation of income and wealth with a view to eliminating double taxation by means inter alia of international agreements*"[36]

It follows that fundamental freedoms do not, in themselves, prevent Member States from exercising their fiscal jurisdiction with respect to the same taxable event. In other words, the parallel taxation by two Member States of the same item of income or wealth does not, *per se*, amount to a restriction on fundamental freedoms by neither of them: which means that neither of them may be regarded as violating the

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32 *Schempp*, §35.

33 Case C-293/06.

34 *Id.*, 23.

35 *Id.*, § 43.

36 See, in this connection, ***Columbus Container*** **(Case C-298/05)** § 27; ***Kerckhaert and Morres*** **(Case C-513/04)**, § 17.

Treaty notwithstanding the objective disadvantage that a taxpayer may suffer on account of international juridical double taxation.

This point has been recently confirmed by the decision in cases such as ***Block***[37] and ***Damseaux***[38].

In *Block* the Court dealt with a Member State's (Germany) provision that, for the purposes of assessing the inheritance tax due by its residents with respect to certain capital claims against debtors that were resident in another MS (Spain), would not credit the inheritance tax paid in such Member State on those claims. As a result, the capital claims at issue were taxed in the Member State of residence of the heir and in the Member State of residence of the capital claims' debtor[39].

The ECJ summarized its thinking with respect to the issue by saying that

> "*in the current stage of the development of Community law, the Member States enjoy a certain autonomy in this area provided they comply with Community law, and are not obliged therefore to adapt their own tax systems to the different systems of tax of the other Member States in order, inter alia, to eliminate the double taxation arising from the exercise in parallel by those Member States of their fiscal sovereignty*"[40].

The *Damseaux* case suggested a similar issue with reference to dividends received from a company resident in another Member State. In particular, the referring court raised the question whether

> "*Article 56 EC precludes a bilateral tax convention, such as that at issue in the main proceedings, under which the dividends distributed by a company established in one Member State to a shareholder residing in another Member State are liable to be taxed in both Member States, and which does not provide that the Member State in which the shareholder resides be unconditionally obliged to prevent the resulting double taxation*"[41].

It must be pointed out that this case did not pose a question of foreign dividends being treated worse-off than domestic dividends (in which case the ECJ's jurisprudence on origin-State selective treatments of "inbound dividends" would

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37 Case C-67/08.

38 Case C-128/08.

39 *Block.* § 28.

40 *Id.* § 31. To that effect see also *Columbus Containers* § 51.

41 *Damseaux* § 23.

have applied[42]); but, "simply" that foreign dividends were taxed in two Member States and that the relevant DTC did not eliminate such double taxation.

The Court held that this issue did not engage fundamental freedoms and that

> "*It is for the Member States to take the measures necessary to prevent situations of double taxation by applying, in particular, the criteria followed in international tax practice*"[43].

In conclusion, the ECJ has no power to neutralize the shortcomings of "non-harmonisation" and/or "non-coordination" among national tax-systems and eliminate the distortions (juridical double taxation being one these) that they are capable of provoking[44].

Interestingly, the only area of direct taxation that the Treaty (art. 293) explicitly "leaves"[45] to Member States is that of the "abolition of double taxation"; as if the Founding Fathers had foreseen that such area was in principle out the ECJ's reach.

What is it, then, that MSs are under the obligation to do or not to do in order to be compliant with the Treaty? When is it that a national tax system may be said to interfere with the Treaty resulting in a violation thereto?

These are the questions that we shall endeavour to give an answer to in the following paragraphs.

3. Patterns of restrictions.

3.1. "*National treatment*"

In one word, Member States' tax systems should not "restrict" the exercise of fundamental freedoms and rights.

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42 See paragraph 4.2.1. of section C.

43 *Damseaux* § 30.

44 This is not to say that these distortions do not amount to an interference with respect to the exercise of the Fundamental Freedoms, but that their elimination exceeds the scope of negative integration. As noted by F. Vanistendael, *Id*. 63 with respect to double taxation (but this holding can be extended to all the consequences of disparities) "*…the ECJ cannot find in the EC Treaty a specific legal basis for setting aside the tax rule of one of the two Member States, and therefore must leave the double burdens in the area of income taxation unresolved, unless it finds a strong indication of how such double taxation should be tackled either in the legislative choice of the EU legislator, or in the choice of the overwhelming majority of national legislators*".

45 See footnote 10.

At the present stage of development of the ECJ's case law[46], a restriction may take different forms. However, the assessment of all forms of restrictions rests on the same analytical tool, that is to say the concept of "national treatment".

Indeed, one may say that the whole ECJ's case-law in direct taxation rotates around this concept[47].

"National treatment" is the tax treatment that a Member State applies to its nationals or residents[48]. That tax treatment may be provided for by purely domestic provisions or by provisions that implement DTCs with other Member States or third countries[49].

By undertaking to comply with the Treaty MSs have essentially accepted to:

i) From a host-State position, make national treatment (or a "not less favourable treatment") available also to nationals to other MSs insofar as, by availing themselves of a fundamental freedom or right, they have become

46 It is well known that the scope of negative integration has considerably evolved since the earlier cases [***Avoir Fiscal*** **(Case 270/83)** is commonly referred to as the first decision in the area negative integration for direct taxation purposes]. In particular, the most important step that the Court has taken is to pass from an analysis centered on the concept of "discrimination" to an analysis centered on the dichotomy between the concepts of "restriction" (to the exercise of a fundamental freedom) and "justification" to that restriction. This shift is credited to the influence of the free movement of goods jurisprudence and in particular from the milestone decisions in ***Procurator du Roi v Dasonville*** **(Case 8/74)** and ***Rewe-Zentrale AG v Bundesmonopolverwaltung fur Branntwein*** **(*Cassis de Dijon* Case 120/78)**.

47 An explicit reference to "national treatment" is made by art. 43 (2) that reads as follows:- "*Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48,* under the conditions laid down for its own nationals by the law of the country where such establishment is effected (…)" (emphasis added). Ever since its first decision on the significance of freedom of establishment with respect to direct taxation the Court noted that "*art. 43 prevents the Member States imposing conditions on persons exercising their right of establishment which differ from those laid down for its own nationals*" (*Avoir Fiscal,* § 23).

48 Although fundamental freedoms prohibit discrimination based on nationality, a restriction based on equivalent criteria -such as that of residence- still amounts to a discrimination. The Court has in fact held that criteria such as residence "*may be tantamount, as regards their practical effect a discrimination based on nationality*" [***Sotgiu*** **(Case 152/73)** § 11]. See also ***Asscher*** **(Case C-107/94)** § 38.

49 In other words, DTCs' provisions are part of the "national treatment" in the same way as purely domestic provisions.

eligible to it (prohibition of host-State "selective restrictions")[50];

ii) From an origin-State position, apply that treatment (or a "not less favourable treatment") irrespective of the fact that its nationals may have availed themselves of a fundamental freedom or right in another MS (prohibition of origin-State "selective restrictions");

iii) In any event, restrain themselves -both in "host" and "origin" settings- from obstructing through their national tax treatment[51] the exercise of fundamental freedoms or rights (prohibition of origin and host-State "non-selective restrictions").

Let us examine in turn the foregoing obligations by matching them with the pattern of restriction that stems from failure to comply with each of them. Once this analysis is completed we shall concentrate on the rationales whereby the ECJ assess "national treatments" compatibility to the Treaty.

3.2. "Selective" and "non-selective" restrictions. Justifications

3.2.1. The "discrimination" perspective

The first pattern of restriction developed by the ECJ is centred on the concept of "discrimination on the grounds of nationality".

Such an approach is still applied by the Court to "selective" host-cases (see § 3.3. below).

With regard to those cases the "selective" adjective is therefore used as an equivalent to "discriminatory on the basis of nationality".

The theoretical background to the reasoning that underpins these decisions is rooted in the understanding of "discrimination" as a treatment that can arise only through

> "*the application of different rules to* comparable *situations or the application of the same rule to different situations*"[52]

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50 This is a very important point: not all EU nationals are entitled to the "national treatment" of any given MS; in fact that entitlement may arise only through the exercise of a Fundamental Freedom. As we shall see, a national to MS "Y" may be entitled to the "national treatment" of MS "X" insofar as, by exercising a fundamental freedom, the same has become "comparable" to nationals to State "X". Here lies the importance of the concept of "comparability".

51 That, for the purposes of this type of restriction, is assumed to be compliant with the obligations pinpointed in the text under *i*) and *ii*).

52 *Id.*, 30.

It is self evident that discrimination assessment, as above recognized, presupposes in its turn "comparability" between the situations that are being taken into consideration. More to the point, the ascertainment as whether a given "national treatment" provided for in Member State "X "must be made available to nationals to Member State "Y" that have availed themselves with a fundamental freedom in Member State "X" predicates certainty as whether the same are comparable to nationals of Member STate "X" with respect to that specific tax treatment. Insofar as there is no such comparability, there is no obligation to extend the national treatment at play and no theoretical room for discrimination[53].

3.2.2. Shifting the boundaries of negative integration: i) the "restriction/justification" dichotomy

As aforementioned, the ECJ has also recognized since the early stages of its direct taxation jurisprudence that Member States must comply with the obligations that stem from fundamental freedoms, not only when they act from a host-State position, but also when they find themselves in an origin-State position[54].

The overarching concept here is no longer *strictu sensu* "discrimination" given that, from an origin-State position, Member States may impose restrictions only upon their own nationals or residents[55]. In other words an origin-State is in general unable to discriminate its own nationals on the grounds of nationality[56].

This particular feature of origin-State restrictions (no *strictu sensu* discrimination on grounds of nationality involved) has drawn the Court to deal with them by availing itself with the reasoning it has developed in the *Dassonville* and, particularly, *Cassis*

53 This, however, does not necessarily mean that the "national treatment" may all the same not amount to a hindrance to the exercise of fundamental freedoms. We shall see below that the scope of the concept of restriction is wider than that of discrimination.

54 *Daily Mail* being the leading case in this connection. The Court has further developed its understanding of the issue that are at the origin of the *Daily Mail* case (that is to the say whether freedom of establishment covers the right of a legal entity to transfer its seat from a MS to another without losing its legal personality in the MS of origin)in ***Cartesio* (case C-210/06).**

55 Reference to "residents" here is not casual: as pointed out by T. O'Shea, *EU Tax Law and Double Tax Conventions*, 44, when a national to MS "X" establishes itself in MS "Y" becoming a resident of it and from there exercises a Fundamental freedom in MS "Z" he is entitled to the same protection against any hindrance thereto as MS "Y"'s own nationals. In other words, MS "Y" has to comply at the same time with host and origin-State obligations with respect to the same taxpayer. See ***Baars* (Case C-215/98)** § 29 for a reference thereof.

56 See paragraph 3.7 below for a further discussion on this point.

de Dijon judgements in the area of quantitative restrictions on the free movement of goods[57].

As a result, the ECJ assesses whether "national treatments" comply with the Treaty not from a "discrimination perspective" but in light of the "restriction/justification" dichotomy which constitutes the analytical tool devised by the aforementioned *Dassonville* and *Cassis de Dijon* jurisprudence.

From this perspective, restrictions are not confined to unjustified different treatments of comparable situations on grounds of nationality, but encompass all those situations were Member State "X", from an origin or host standpoint, fails to grant "national treatment":

- To its own nationals when they exercise a fundamental freedom in Member State "Y";

- Or to nationals of other Member States when they exercise a fundamental freedom in the Member State "X" itself.

The conditions whereby the Court may justify restrictions which do not entail discrimination on the ground of nationality[58] are enshrined in the following "formula" laid down in the ***Gebhard*** case[59]: those restrictions

> "*must be justified by imperative requirements in the general interest, they must be suitable for securing the attainment of the objective which they pursue and they must not go beyond what is necessary in order to attain it*"[60].

The justifications that have been accepted by the Court are essentially the need for:

- Ensuring effective fiscal supervision;

- Protecting the coherence of the tax system;

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57 See P. Craig-G. De Burca, *Id.*, 679 and ff. for further references on the subject. For a useful account of the step forward made by the Court from the approach based only on discrimination to the approach based on the restriction/justification dichotomy, see AG Maduro opinion in *Marks & Spencer* § 27-30 and L Hinnekens, *The search for the framework conditions of the fundamental EC Treaty principles as applied by the European Court to Member States' direct taxation,* EC Tax Review 2002, 112.

58 As we shall see below, a differing feature of restrictions based on discrimination (on ground of nationality) and other restrictions is that the latter may be justified on the basis of the "rule of reason" referred to in the text. See also paragraph 3.7.

59 Case C-55/94.

60 *Id.,* §37.

- Preventing tax avoidance;

- Preserving the correct allocation of taxing powers between Member States (territoriality).

3.2.3. Follows: ii) "non-selective" restrictions.

It must, however, be pointed out that "selective restrictions" are not the only restrictions that may come to the fore in host and origin-State settings alike. In fact Member States may implement treatments that are restrictive despite the fact that they are not selective because even-handed ("total restrictions") or because the situations at hand are not comparable.

In other words, the Court is not satisfied with the fact that a "national treatment" makes no distinction according to the nationality or residence of the taxpayer (in a host-State scenario) or of the fact that its own nationals or residents seek to exercise a fundamental freedom in another Member States (in an origin-State scenario): indeed it must also ascertain whether that treatment amounts all the same to an obstacle or hindrance to the same freedoms.

To that end the Court avails itself of the same restriction/justification dichotomy that we have above-referred to.

Such an approach, developed in an origin-State setting, has therefore been extended also to host-State cases in situations where there is no discrimination based on nationality: the Court, having ascertained that a "national treatment" does not entail a nationality-based discrimination, passes directly to a restriction analysis followed, were necessary, by a justification analysis[61].

3.3. Host-State "selective restrictions"

Decisions as *Avoir Fiscal*, ***Commerzbank AG***[62] and ***Royal Bank of Scotland***[63], on the one hand, and ***Schumacker***[64], on the other, epitomize instances of selective restrictions with respect to freedom of establishment and free movement of workers respectively.

In the freedom of establishment cases the ECJ was confronted with situations where:

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61 See below the *Futura* and *Truck Center* cases.

62 Case C-330/91.

63 Case C-311/97.

64 Case C-279/93: as we shall see below the ramifications of the decision in *Schumacker* go far beyond the scope of Free movement of workers.

- On the one hand, a company having its seat in a Member State attempted to exercise the freedom of establishment in another Member State by setting up a branch in its territory;

- On the other hand, the latter Member State (the host-State) applied a tax treatment to that branch which differed from the tax treatment generally applied to companies having their seat in such Member State.

In other words, the host-State failed to extend the "national treatment" to the branch of the foreign company.

In the *Schumacker* case the Court dealt with a domestic provision whereby resident taxpayers were entitled to tax reliefs and rebates so as to take into account their overall ability to pay and, more specifically, their personal and family circumstances. This treatment (the "national treatment") was denied to non-resident taxpayers even though, upon exercise of the freedom of movement of workers, they earned the major part of their ability to pay in the host-State.

As above said the ECJ uses here the "national treatment" (current in France) principle in the contest of a "discrimination-centred" understanding of the concept of restriction.

For instance, in *Avoir Fiscal*, with respect to a "national treatment" consisting of a measure aimed at eliminating economic double taxation on dividends (the "national treatment" at play in that case), the Court concluded that :

> "*by failing to grant to the branches and agencies in France of insurance companies whose registered office is in another MS the benefit of shareholders' tax credit in respect of dividends paid by French companies to such branches or agencies, article 158* ter *of the Code General des impots does not apply to those companies the conditions laid down by French law for insurance companies whose registered office is in France. That discrimination constitutes a restriction on the right of establishment of insurance companies whose registered office is in another MS, which is contrary to the first and second paragraphs of article 52 of the EEC Treaty*"[65]

Similarly in *Schumacker* the Court concluded that

> *"In the case of a non-resident who receives the major part of his income and almost all his family income in a Member State other than that of his residence, discrimination arises from the fact that his personal and family*

65 *Avoir Fiscal,* § 27.

> *circumstances are taken into account neither in the State of residence nor in the State of employment*"[66].

Under this pattern of assessment the ECJ has drown conclusions that are by no means short of "revolutionary" in terms of settled principles of international tax law.

In the freedom of establishment cases, the Court found that, with respect to the claimed "national treatment" relevant to each of them, foreign companies' branches and resident companies were placed on the "same footing" (*id est*: taxed in the same way) and, as a result, comparable[67].

In the *Schumacker* decision the Court was drawn to a similar conclusion with respect to a non-resident individual. Insofar as the same obtained the major part of their income in the Member State where they he had exercised the free movement of workers' right, the ECJ concluded that they were comparable to residents with respect to the "national treatment" they had claimed to be entitled to[68].

By addressing this first pattern of restriction we have for the first time come in contact with the concept of "comparability". Before concentrating on it as a subject in its own merit, we must however continue our analysis so as to understand how such concept is relevant to the other patterns of restriction that we have pinpointed at the end of the previous paragraph.

3.4. Host-State "non-selective" restrictions

It has been highlighted above that the Court is not satisfied with the fact that a "national treatment" entails no selective restriction as a result of the fact that it is "even-handed" or that the situations at play are not comparable: indeed it also ascertains whether that treatment amounts all the same to an obstacle or hindrance to fundamental freedoms.

In ***Futura***[69], the Court had to examine the conditions that branches of foreign companies had to meet in Luxembourg to carry-forward previous losses: namely that those losses derived from activities carried in the territory of that State and that the foreign companies kept and held accounts relating to such activities in compliance with the relevant domestic rules.

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66 *Schumacker,* § 38

67 *Avoir Fiscal* § 20; *Commerzbank* § 18-19; *Royal Bank of Scotland* § 28.

68 *Schumacker* § 37: "*There is no difference between the situations of such a non-resident and a resident engaged in comparable employment, such as to justify different treatment as regards the taking into account for taxation purposes of the taxpayer's personal and family circumstances*".

69 Case C-250/95.

The Court swiftly rejected the claim that the first condition amounted to discrimination[70]. With respect to the second condition it concluded on the contrary that, while not discriminatory, the requirement to keep and hold separate accounts may constitute a restriction on the freedom of establishment[71].

The foregoing amounts to what may be referred to as "total restriction", that is to a say a rule that, despite being applied indistinctly to nationals and non-nationals, even so ends up deterring in factual terms the latter from exercising the fundamental rights that the Treaty has availed them with[72].

The ECJ, pursuant to the restriction/justification approach ascertained then whether a justification may apply; the conclusion thereto being that, although the "need to ensure effectiveness fiscal supervision" was relevant to the case[73], the measures at hand went beyond what was necessary for the attainment of such purpose[74].

In the recent ***Truck Center*** case[75] the Court had to assess the compatibility of a withholding tax on interest paid by a subsidiary (borrower) to its non-resident parent company (lender) that was not applied to interest paid, in similar circumstances, to resident lenders. The ECJ's first finding was that the two situations of the resident and non-resident lenders were not comparable and, as a result, there was no room for complaining discrimination[76]; it then went on to assess whether the treatment was even so restrictive and it concluded for the negative on the grounds that the withholding tax burden was lower than the corporation tax burden imposed on resident lenders[77].

The decision is revealing because it demonstrates that even where the Court finds that the "national treatment" entails no discrimination for lack of comparability - rather than because the relevant provisions are not discriminatory in themselves (as in *Futura*) - it nevertheless applies the restriction/justification dichotomy test.

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70 *Id.*, § 22.

71 *Id.*, § 24.

72 Which, from an origin-State perspective, is what takes place in *Bosman*.

73 *Id.*, § 36

74 *Id.*, § 40.

75 Case C-282/07. See for further discussion of the case par. 4.3.2. of section C

76 *Id.* § 41.

77 *Id.* § 49.

3.5. Origin-State "selective restrictions"

After *Daily Mail*, the case that better puts in evidence the role of the "national treatment" concept in an origin-State setting and, more in general, the rationales behind this pattern of restriction is probably that of ***Marks & Spencer* v *Halsey***[78].

In particular, having been asked whether the UK group relief legislation was compatible with freedom of establishment given that it did not include losses incurred in by non-resident subsidiaries, the ECJ went straight to the point of ascertaining comparability and then whether such "national treatment" was even-handed[79].

Having found comparability between resident parent-companies with resident subsidiaries, on the one hand, and resident parent companies with non-resident subsidiaries, on the other, the Court concluded that failure to apply the group relief regime to the latter amounted *per se* to a restriction on the fundamental freedom that the applicant had relied upon[80].

The Court turned then its attention to the applicability of justifications coming to the conclusion that, although in principle acceptable under three different patterns of justifications "*taken together*[81]", the restriction at hand was nevertheless not proportionate other than in situations where the losses had to be regarded as terminal or final[82].

This decision is of great importance for the wide range of issues that are addressed by it; yet what makes it interesting for our purposes is the straightforward use that it makes of the "national treatment" principle in relation to the restriction/justification dichotomy and the comparability it establishes **-**with regard to the rule at play in the main proceeding**-** between a national legal entity that sought to avail itself with freedom of establishment and any other national legal entity[83].

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78 Case C-446/03.

79 *Id.* § 33

80 *Id.* § 34.

81 *Id.* § 51.

82 *Id.* § 55

83 *Marks & Spencer*'s presupposes and synthesizes the thinking that underpins other decisions where resident companies with respectively resident and non-resident subsidiaries are compared to each other with regard to national provisions that afforded "less favorable treatment" to the latter; see for instance ***ICI* (Case C-264/96)** § 30 and ***Bosal Holding* (Case C-168/01)** § 27. The Court has consistently rehearsed its stance in subsequent cases as ***Keller Holding* (Case C-471/04)** § 41 and ***Cadbury Schweppes* (Case C-196/04)** § 45.

3.6. Origin-State "non-selective" restrictions

With regard to this pattern of restriction there is perfect symmetry between the host and origin-State case-law. In particular, the Court has approached non-selective restrictions with the same analytical tools that we have seen at play in the host-State cases.

In ***Bosman***[84], a non-tax case that has nevertheless huge importance for direct-tax purposes, the Court found that national transfer rules applicable to football players wishing to move from a club to another entailed a restriction on the free movement of workers notwithstanding the fact that those rule applied also to "internal transfers"[85].

The ECJ, consistently with the restriction/justification approach, went on to examine whether any justification may apply to the restriction[86]

A more recent case where the Court challenged the restriction on the exercise of fundamental freedoms of a national provision despite the fact that the same made no distinction as to whether or not a fundamental freedom had been exercised may be that of ***Deutsche Shell***[87].

As aforementioned[88], the case concerned a measure that excluded from the national basis of assessment currency losses suffered by a resident company on occasion of the repatriation of start-up capital granted to its permanent establishment in another Member State. The ECJ went straight to the point of noting that the provision at issue in the main proceeding

> "*increases the economic risk incurred by a company established in another Member State wishing to set up a body in another Member State where the currency used is different from that of the State of origin. In such a situation, not only does the principal establishment face the normal risk associate with setting up such a body, but it must also face an additional risk of fiscal nature where it provides start-up capital for it*"[89].

84 Case C-415/93

85 *Id.* § 100.

86 *Id.* § 104.

87 Case C-293/06.

88 See Paragraph 1 of section A.

89 *Id.,* 30.

It seems clear that inasmuch as the case presupposed the use of a "different currency", the restriction was not a matter of failure to grant "not less favourable treatment" to the cross-border situation *vis à vis* the domestic one (given that such "national treatment" did not address the problem from a domestic standpoint either); the issue was that the "national treatment" was in itself restrictive on the exercise of fundamental freedoms[90].

The symmetrical case to *Truck Center* in an origin-State setting may be considered that of *Schempp*, which we have analyzed discussing "disparities". In both cases the Court found no comparability. In particular in *Schempp* the Court concluded that the cross-border situation (maintenance paid to non-resident recipient) was not comparable to the domestic situation (maintenance paid to resident recipient) and that, as a consequence, there could be no discrimination "*within the meaning of art. 12*" of the Treaty[91]. The ECJ, however, went on to further examine whether the national provision, even so, entailed a restriction to the freedom to move and reside in another MS under art. 18 of the Treaty and it reached the conclusion that the tax disadvantage was not entailed by a restriction but, as we know, by a disparity[92].

3.7. Usefulness of the distinction between "selective" and "non selective" restrictions.

In light of the foregoing, the restriction assessment may lead essentially to the six outcomes outlined below and matched with (one of) the appropriate leading cases thereof.

The "national treatment" may be:

Host-State scenario

1. Selective in a "discrimination" sense (*Schumacker*);
2. Non-selective yet restrictive (*Futura*);
3. Non-selective and non-restrictive (*Truck Center*).

Origin-State scenario

4. Selective (*Marks & Spencer*);

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90 According to the view put forward by M. Lang, *Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions, and Contradictions,* EC Tax Review, 3, 2009, 99 this case actually featured a discrimination based on the fact that the national treatment made no distinction between different situations. In this connection I respectfully submit that the analytical tool here is not discrimination, which the Court does not seem to be (in my view correctly) interested in, but restriction.

91 *Id.* § 35.

92 *Id.* § 44 – 45.

5. Non-selective yet restrictive/"total restriction" (*Bosman*);

6. Non selective and non-restrictive (*Schempp*).

As above said, with the exception of the first pattern of restriction (which entails "discrimination on the grounds of nationality"), the Court carries out this analysis by applying the "restriction/justification" dichotomy.

One may ask why it is worth making a distinction between "selective" and "non-selective" restrictions. The reasons are, in my opinion, essentially two:

- The first one, which applies only to host-State restrictions, is that whereas "selective restrictions" may be justified only by public interests that are listed in the Treaty (as public health or safety), "non-selective" restrictions (either or not "total") can also be justified under the "rule of reason" test devised by the ECJ's case law;

- The second one, which applies both to origin and host-State restrictions, is that where the Court ascertains that the "national treatment" is selective (*id est*: it affords less favourable treatment) it has no need to further investigate on its effects on the exercise of fundamental freedoms: indeed, a selective treatment is *per se* a restriction (with no prejudice to the applicability of justifications). Conversely, where that "first stage" assessment highlights no distinction in the treatment of nationals and non-nationals that have exercised a fundamental right (in a host-State setting), or of nationals that have availed themselves with fundamental freedoms and those who have not (in an origin-State setting) the Court has to engage in a "second stage" analysis to ascertain whether such treatments even so amounts to a restriction (with no prejudice to the applicability of rule of reason justifications).

In this connection it should be noted that whereas the "first stage" analysis is a purely legal one (does the "legal treatment" differentiate between comparable situations?) the second presupposes a more factual and empiric analysis (is, "in factual terms", the "legal treatment" restrictive although not selective?). To this end it is interesting to highlight what the Court noted in this respect in a non-selective restriction case as *Deutsch Shell*:

> "*As the Advocate General observed in points 43 and 44 of her Opinion, the tax system concerned in the main proceeding* increases *the economic risks incurred by a company established in one MS wishing to set up a body in another MS where the currency used is different from that of the State of origin. In such a situation, not only does the principal establishment face the normal risks associated with setting up such a body, but it must also*

> *face an additional risk of fiscal nature where it provides start-up capital for it*"[93].

The "increase of the economic risks" finding is, in my opinion, the result of an appreciation of factual elements.

Similarly from a host-State perspective in *Futura* and *Truck Center* the Court had to embark on a sort of "quantitative" rather than "qualitative" analysis: that is to say the amount of additional costs that a non-resident company may suffer as a result of the decision to set up a branch in another Member State (*Futura* § 25) and the actual amount of tax levied with respect to interest paid to a non-resident parent company *vis à vis* to a resident parent company (*Truck Center* § 49).

It may thus be submitted that -having regard to the role that the Court is entrusted with under art. 220 of the Treaty ("*ensure that in interpretation and application of the Treaty the law is observed*")- such analysis is considerably more challenging -in terms of accountability and consistency- than the legal analysis carried out to assess whether a national tax system makes a distinction between comparable tax situations.

It has to be pointed out that the ECJ's policy to put under the same analytical roof selective and total restrictions in an origin-State scenario and, in particular, to apply the "rule of reason" to both them has attracted considerable criticism[94].

The claim is that selective restrictions are actually grounded on nationality, even if only indirectly. For instance, in ***Baars***[95], the Court applied the restriction/justification dichotomy[96] after having recognized that the less favourable treatment at play was applied only to shareholdings in companies having their seat in other MSs (and therefore nationals thereto)[97]. In other words, the restriction

93 *Deutsche Shell* § 30 (emphasis added).This particular point offers a further occasion to comment on the view put forward by M. Lang, *Id*, 99, according to which "*Losses that are nowhere taken into account do not lead to discrimination as such. Certain expenses may not be deductible in the State of residence or in the State of source,* without constituting an infringement to the freedoms" (emphasis added). This position is rehearsed at footnote 9 where is held that "*if German rules had not allowed the deductions at all, the freedoms would not require the deduction of currency losses* either". Actually, the case at issue (as the *Bosman* case by the way), proves exactly the contrary, that is to say that even where the national treatment makes no distinction it may even say entail a prohibited restriction.

94 See, for instance, R. Lyal, *Non discrimination and direct tax in Community Law,* EC Tax Review 2003, 71.

95 Case C-251/98.

96 *Id*. § 32.

97 *Id.* § 30.

contained an element of discrimination based on nationality because the applicability of the restrictive tax regime followed the foreign nationality of the company the capital of which had been invested in the pursuit of freedom of establishment.

In this connection I submit that, according to the ECJ's understanding of negative integration, the concept of "restriction based on discrimination" is to a certain extent recessive. Such concept is being overtaken by the more far-reaching and flexible concept of "restriction ("selective"[98] or "non-selective"[99]) on the exercise of fundamental freedoms".

By investigating a Member States tax systems from the "restriction/justification" standpoint (rather than from the "restriction-based-on-discrimination" standpoint) the Court is indeed able to:

- On the one hand, which has already been noted, challenge all restrictions irrespective of the fact that they entail or not a discrimination based on the nationality of the taxpayer;

- On the other hand, give MSs leeway in protecting their tax systems from the undesirable effects of negative integration under the rule of reason justifications.

Moreover, I may point out that this approach is far more apt to address the complexities of fiscal compatibility with the Treaty than a purely discrimination-based one and, as such, to fend off claims that the Court adopts a too formalistic methodology in deciding tax cases[100].

C "Comparability" as a prerequisite of "selective restrictions"

1. The need for comparability is a consequence of the "national treatment principle"

The foregoing analysis shows that all forms of selective restriction presuppose a preliminary scrutiny on the comparability of "two situations" and of the tax treatments Member States afford to each of them respectively:

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98 See paragraph 3.2.2. above.

99 See paragraph 3.2.3. above.

100 As held by R. Mason, *Flunking the ECJ's Tax Discrimination Test* available at http://ssrn.com/abstract=1025522.

- In a host-State setting, the situations are those of a national and of a non-national that has availed himself with a fundamental freedom[101];

- In an origin-State setting, the situations of a national that has not exercised a freedom and a national that has exercised it[102].

The need for that scrutiny descends from the "national treatment" principle we have discussed earlier: to the extent that host and origin-States must grant "not less favourable treatment" to cross border situations than to domestic ones, in order to assess compliance with such obligation the Court has to first of all establish comparability between the one and the other.

We have seen this from a host perspective in *Avoir Fiscal*, were the Court compared the treatment afforded by a MS to a resident company and to a non-resident company with a branch in that MS; but also from an origin perspective in *Marks & Spencer*, were the Court compared the treatment of resident parent companies whose subsidiaries were respectively resident and or non-resident companies.

Comparability comes therefore into play not only in a "discrimination dimension" - where it was first analyzed- but also in "restriction/justification" dimension.

It is true, on the other hand, that comparability has a different relevance (and, hence, importance) in host and origin-State cases respectively.

2. The different relevance of comparability in host and origin-State settings.

2.1. Comparability with respect to host-State rules

2.1.1. "Legal doorway" to Treaty protection

In a host-State setting comparability is the "legal doorway" through which nationals of other Member States may benefit from the "national treatment" of a Member State acting in that (host-State) capacity.

It is clear, in fact, that not *all* EU nationals have access to *all* Member States' "national treatments": only nationals that are in a situation comparable to residents of the Member State where they wish to exercise a fundamental freedom are entitled thereto.

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101 According to the useful terminology devised by T. O'Shea, *Id.*, 42, the national is referred to as the "non-migrant" and the non-national as the "migrant".

102 Pursuant to the "migrant/non-migrant test" (see previous footnote), the national who exercises the freedom is referred to as the migrant whilst the national who does not exercise the freedom is referred to as the non-migrant.

We have seen this, for instance, in *Schumacker* where a non-resident's claim to benefit from tax advantages afforded to residents in the Member State where he had exercised free movement of workers' right was actually upheld only after the Court had recognized that he was comparable to those residents[103].

The same is true, for instance, for *Avoir Fiscal*, *Commerzbank* and *Royal Bank of Scotland* where the same reasoning applied to branches of non-resident companies *vis à vis resident* companies: the Court first of all analyzed whether companies resident in a Member State and non-resident companies with a branch in the same Member State were comparable.

2.1.2. "Most Favoured Nation" issues

The "legal doorway" role of comparability in a host-State environment is furthermore demonstrated by cases where came into play a "most favoured nation" (MFN) issue, as for instance in cases such as *Matteucci*, *Saint Gobain*[104], the "*D case*[105]" and *ACT Group Litigation*, or a limitation of benefits" (LoB) issue, as for instance *Open-Skies* case[106] and *ACT Group Litigation* itself.

In *Matteucci*[107] (a non tax case), a Member State had entered into a cultural agreement with another MS whereby nationals to each of those States could apply in the other State for grants awarded for training and maintenance. A national to a third Member State, who worked and resided in the Member State under consideration, applied for the grant but was refused on account of her nationality. The case that followed thereto was referred to the ECJ which reached the conclusion that insofar as [under article 7 (2) of Regulation n. 1612/68] a Member State was under the obligation to make sure that any worker who is national of another Member State and who is established in its territory enjoys "the same social advantages as national workers", the applicant, by actually establishing herself in the territory of the Member State in question, had actually gained entitlement to apply for the disputed "national treatment"[108]. The case is important because it demonstrates the "doorway" function of comparability: the "national treatment" was awarded, not

103 Subsequent cases as ***Ritter-Coulais*** **(case C-152/03)**, ***Lakebrink*** **(Case C-182/06)** and ***Renneberg*** **(C-527/06)** have extended the *Schumacker* reasoning (devised with respect to the taking into account of personal and family circumstances) to the taking into account of expenses stemming from foreign dwellings and, more in general, real estate: see Paragraph 4.2.2. below.

104 Case C-307/97.

105 Case C-376/03.

106 *Commission v Germany,* Case C-476/98.

107 Case C-235/87.

108 *Id.,* §16.

only because of the applicant's (EU) nationality, but also because, by establishing herself in the territory of the Member State in the exercise of her freedom of movement, she had become comparable to nationals of the same Member State.

Similarly in *Saint Gobain* two DTCs between a Member State and third country (USA and Switzerland) granted (only) to resident companies certain tax advantages relating to the taxation of dividends from shares in companies resident in those third countries. A company resident in another Member State had established itself in the Member State under consideration through two branches that held in their turn shares in companies that were resident in the third countries; the non-resident company applied (through its branches) for the tax advantage at issue but was refused on grounds of residence. The Court noted that resident companies and branches of non-resident companies were comparable[109]; it followed that

> "*In the case of a double-taxation treaty concluded between a Member State and non-member country, the national treatment principle requires the Member State which is party to the treaty to grant to permanent establishments of non-resident companies the advantages provided for by the treaty on the same conditions as those which apply to resident companies*[110]".

In the *D-case*[111] the Court applied the same reasoning with respect to a "tridimensional" situation.

The factual background consisted of a Dutch provision whereby a tax advantage relevant to wealth tax was granted to residents of the Netherlands, to non-residents that held 90% of their wealth in that Member State and to non-residents that were resident in Member States (namely Belgium) that had in place DTCs with the Netherlands that extended to them the tax advantage at play.

The claimant in the main proceeding held only 10% of his total wealth in the Netherlands; moreover, as a German resident, he was not, as such, entitled to the tax advantage because the Netherlands-Germany DTC did not provide for it.

The claimant lamented that he was being discriminated with respect to residents of the Netherlands and with respect to residents of Member States -such as Belgium- that had concluded a DTC with the Netherlands that extended to it residents the tax advantage at issue.

The ECJ noted that the claimant was neither comparable:

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109 *Saint Gobain,* § 47.

110 *Id.,*58.

111 Case C-376/03.

i) To a resident of the Netherlands, because he had only 10% of his wealth in its territory:

> "*a taxpayer who only a minor part of his wealth in a Member State other than the State where he is resident is not, as rule, in a situation comparable to that of residents of that other Member State and the refusal of the authorities concerned to grant him the allowance to which residents are entitled does not discriminate against him*"[112];

ii) Nor to a resident of Belgium. In this connection the Court observed that the fact that the reciprocal rights and obligation that stem from a DTC

> "*apply only to persons that are resident in one of the two contracting Member States is an "inherent consequence" of bilateral double taxation conventions"*[113].

As a result,

> "*a taxable person resident in Belgium is not in the same situation as a taxable person resident outside Belgium so far as concerns wealth tax on real property in the Netherlands*"[114].

One may synthesize the foregoing as follows. The Court had recognized since *Avoir Fiscal* that DTC's tax advantages are integral to Member States' "national treatment" and, as such, they must be granted also to non-residents that are comparable to residents. What the ECJ has then pointed out in the *D-case* is that, although DTCs are "international" agreements, they are nevertheless "bilateral" by their own nature. It follows that:

- As tax advantages provided for by at a Member State's domestic legislation level are accessible "only" to its residents and to comparable non-residents;

- "DTC tax advantages" are accessible "only" to residents and to comparable non-residents of the two contracting Member States.

In other words, where a tax advantage is provided for by a DTC, there are two, rather than only one, "national treatments"; yet, apart from that, the comparability mechanics are exactly the same.

112 *Id.,* § 38: the echo of the Schumacker doctrine is evident.

113 *Id.,* § 61.

114 *Ibidem.*

The *D-case* reappeared in a different form in the *ACT-IV-Group-Litigation* case[115] with respect to

> "*the entitlement to a tax credit laid down in a DTC concluded by a Member State with another Member State for companies resident in the second State which receive dividends from a company resident in the first State does not extend to companies resident in a third State with which the first State has concluded a DTC which does not provide for such an entitlement*"[116].

Similarly to the *D-case* the Court noted that companies resident in a contacting State that granted the tax advantage under the relevant DTC and companies resident in a contracting State that did not grant the tax advantage under the relevant DTC where not, as such, comparable. It followed that the tax advantage in question could not be claimed by the latter companies[117].

2.1.3. "Limitation of Benefits" issues

In *Open-Skies* (a non-tax-case) the ECJ dealt with a clause laid down in an international agreement between a Member State and a third country whereby benefits provided for by the same agreement were made non-accessible to resident companies of which a substantial part of the ownership and effective control was not vested in that Member State or in nationals thereto[118].

The Court recalled its decisions in ***Gottardo***[119] and *Saint Gobain* to point out that under the principle of "national treatment" a Member State that is party to an international agreement with a third country is required to grant to comparable non-residents the advantages provided for by that agreement "on the same conditions" as those which apply to residents of the Member State in question[120]. With respect to the LoB clause at hand the Court noted that, inasmuch as the limitation was based on the shareholders' nationality, non nationals were *per se* prevented from benefiting from the treaty even in situations where -by availing themselves with freedom of establishment- they had set up a company in the territory of the contacting Member State [121]. In other words, the "national treatment" was necessarily precluded to non-

115 Case C-446/04.

116 *Id.,* § 92.

117 *Id.* § 92.

118 LoB clauses are devised essentially to tackle schemes whereby companies resident in MSs that are not party to a given international agreement may even so benefit from it by setting up an interposed subsidiary in a MS that is party to that agreement.

119 Case C-55/00.

120 *Id.* § 149.

121 *Id.* § 151

nationals even where they had become comparable to nationals with respect to the national provision at issue.

In the *ACT-IV-Group-Litigation* case we have seen that a DTC provision, which provided for a tax credit devised to eliminate economic double taxation on dividends, triggered a MFN issue. On top of that the provision contained also a LoB clause on the entitlement of the tax credit. In particular, the relevant provision made the availability of the tax credit in question conditional on the fact that the parent company resident in the Member State that had concluded the DTC which provided for the tax credit was not owned, directly or indirectly, by a company resident in a third country or in a Member State with which the Member State of residence of the subsidiaries had concluded a DTC that did not provide for such a tax credit.

The Court, consistently to its findings with respect to the MFN question, concluded that to regard the provision at hand as discriminatory would presuppose that the situation of companies resident in a Member State that had concluded a DTC that provided for the tax credit and companies resident in a Member State that had not concluded such a DTC were comparable. Yet, as stated in *Schumacker*[122], residents and non-residents are not, as a rule, comparable to residents and, as such, Member States are entitled to treat them differently. In any event, as confirmed by *Schumacker* itself, in certain situations non-residents may become comparable to residents by exercising a fundamental freedom and thereby gain access, as comparable taxpayers, to the benefits provided for by the DTC's provisions of the Member State they have exercised such freedom in.

This explains the crucial difference between the *Open Skies* case and the *ACT-IV-Group-Litigation case*: whereas in the latter the LoB clause was based on nationality, and nationality is not an admitted "doorway" within the internal market, in the latter it was based on residence which, to the contrary, is a ground upon which national treatment may or may not be made available. In other words, whereas residents and non-residents may or may not be comparable to each others, nationals and non-nationals are always comparable within the European Union.

It is implicit in the foregoing that where the Court finds that a non-national or a non-resident passes the "legal doorway" comparability test, any tax-treatment thereof short of the "not less favourable" threshold amounts to a prohibited discrimination.

3. Comparability with respect to origin-State rules

As discussed above, in a host-State setting non-resident individuals or legal entities that exercise fundamental freedoms have to be comparable to resident individuals or legal entities in order to qualify for "national treatment's" eligibility ("legal doorway" role of comparability).

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122 Case C-279/93.

This is not the case in an origin-State setting. Legal entities or individuals that are nationals to, or residents of, a Member State that lays down a given "national treatment" are, *per se*, taxpayers entitled to that "national treatment".

However, origin Member States may retain tax advantages or apply tax disadvantages not by reason of the nationality or the residence of the taxpayer but on account of the fact that its nationals exercise their activities on a cross border basis or move to another Member State or establish themselves in the same. In these situations the obligations that Member States have undertaken to comply with by signing the Treaty entail that they must grant "national treatment" irrespective of the fact that their nationals or residents have availed themselves with fundamental freedoms and rights.

What is therefore "comparability" all about in this connection?

The fact that a Member State differentiates the tax treatment of comparable situations according to whether the taxable event embeds or not a Treaty-protected cross-border action (as that of setting up a branch or a subsidiary in another Member State, as investing in the share capital of a company resident in another Member State, as providing services to a client resident in another Member State, as moving one's residence in another Member State etc.) entails that such treatment amounts, *per se*, to a prohibited restriction with no need for further investigation (other than for justification purposes).

The relevant cases in this connection shall be discussed below; at this point it may be interesting to refer to the decision in ***Lidl Belgium*** case[123] as a valuable instance of the foregoing.

The factual background consisted of a national provision according to which resident companies were not entitled to deduct losses incurred in by their permanent establishments only where the same were situated in another Member State. Although the Court makes some dubious statements on the characterization of permanent establishments as "entities" and furthermore indulges on the unconvincing concept of "resident permanent establishment" (which should be dubbed as an "ongoing concern within the territory of the Member State where the principal company is resident") it nevertheless clearly synthesises the role of comparability in an origin-State environment:

> *"As regards the tax regime at issue in the main proceeding, it must be pointed out that a provision which allows losses incurred by permanent establishments to be taken into account in calculating the profits and taxable income of the principal company constitutes a* tax advantage.

123 Case C-414/06.

> *However, the provision of that tax regime do not grant such a tax advantage where the losses are incurred by a permanent establishment situated in a Member State other than that in which the principal company is established.*
> *In those circumstances, the tax situation of a company which has its registered office in Germany and has a permanent establishment in another Member State is less favourable than it would be if the latter were to be established in Germany. By reason of that difference in tax treatment, a German company could be discouraged from carrying on its business through a permanent establishment situated in another Member State.*
>
> *It must be held that the tax regime at issue in the main proceeding involves a restriction on the freedom of establishment".*

The Court clearly sees a difference in treatment of comparable situations as a restriction in itself.

Thus, in an origin-State environment, (unjustified) different treatment of comparable situations amounts *per se* to a restriction with no need for further analysis. In other words, comparability is itself a self sufficient "first stage" assessment of the existence of restrictions.

4. Assessing comparability.

4.1. The relevance of the national provision's purpose

To assess comparability the Court, at the outset of its decisions, gives an account of the factual background to the case and of the legal framework which is material to it. Through this factual and legal examination the Court provides for a description of how the two situations are treated.

Factored in that process is the crucial element to the comparison, that is to say the choice of the appropriate comparator.

The rationales of that choice rest on the premise that the "*less favourable treatment*" that entails a (selective) restriction may be enacted thorough essentially two means:

- by denying a "tax advantage";

- or by applying a "tax disadvantage".

Having this in mind the analytical steps that are necessary to establish the relationship between the two situations are the following:

i) Determine which is the tax advantage or the tax disadvantage at play in the main proceeding;

ii) Identify who is the "taxpayer" that suffers the "less favourable treatment"[124];

iii) Determine the conditions under which the tax advantage or the tax disadvantage may respectively be applied and assess whether the exercise of a fundamental freedom is itself (as a factual matter) relevant as a condition[125].

As the following analysis of the Court's jurisprudence should demonstrate, with respect to the third step the Court gives great importance to the "purpose" of the domestic provision that enacts the tax advantage or the tax disadvantage; it is, in fact, in light of such element that it establishes whether a Member State is being or not even handed in applying a given "national treatment" In particular, the Court takes into account the purpose of the domestic provision to ascertain whether there are reasons, in light of it, to support the fact that it is applied only to "non migrants"[126] (where there is a tax advantage at stake) or only to "migrants" (where a tax disadvantage is at stake).

This point was efficiently made by AG Mengozzi in his opinion to the **Amurta**[127] case, where the Court was confronted with a national tax regime (current in the Netherlands) whereby dividends distributed by resident companies to fellow resident companies (or to permanent establishments of non-resident companies that held the shares in the distributing company) were exempted from withholding tax. The exemption at play was not, however, applied to dividends distributed to non-resident companies.

The AG noted that comparability between resident and non-resident recipient of dividends had to be established having regard

> *"to the purpose and content of the national provisions in question"* [128]

or, in other words,

> "*to the function of the contested legislation*"[129].

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124 For instance, it was crucial to the Court's understanding of the freedom of establishment's relevance to the *Marks & Spencer* case to identify in the parent company with foreign subsidiaries the "taxpayer" that suffered the restriction.

125 See for instance *Baars* § 30 and 31 and ***Asscher*** **(case C-107/94)** § 42.

126 See footnote nr. 101.

127 Case C-379/05

128 AG opinion in *Amurta* § 37.

129 *Id.* § 38

Having noted that the purpose of the exemption was to

> "*eliminate the imposition of a series of liabilities to tax on profits distributed by Netherlands companies*"[130]

the AG draw the conclusion, upheld by the ECJ[131], that insofar as

> "*the 'source State' decides to save its own residents from domestic double taxation by exempting them from withholding tax on dividends received from a Netherlands company, that State must extend that exemption to non-residents since they suffer the same domestic double taxation as a result of the exercise of its power of taxation over them*"[132].

Possibly, establishing comparability may be easier with respect to tax disadvantages. In fact, their very purpose is commonly that of treating in a different way situations which have a cross-border element in them *vis à vis* purely domestic ones and this makes them to a large extent self-evident.

On the contrary, tax advantages are normally not devised having in mind the EU dimension -they might even have been put forward when the Community was not operative- and are "hidden" in Member States' domestic tax legislations. As a result, establishing the comparison requires a higher scale of construction and may be, all in all, more "creative".

In other words, whereas the purpose of tax disadvantages usually imbeds a cross-border element in it that makes them *per se* restrictive (that is to say: the disadvantage is clearly aimed at non-residents or at residents that exercise a fundamental right in another Member State), tax advantages are likely to result restrictive only once the appropriate comparison with the appropriate cross-border situation has been established. It may therefore be submitted that assessing comparability is more challenging with respect to tax advantages than to tax disadvantages.

4.2. Tax advantages

The Court has established comparability with respect to tax advantages in host and origin-State environments.

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130 *Id.* § 39

131 See § 39-40 of the decision. The obligations of a MS that acts as the "source-State" of dividends with respect to measures devised to eliminate economic double taxation on the same dividends were addressed for the first time in ***ACT IV Group Litigation*** **(Case C-374/04)**..and in ***Denkavit France*** **(Case C-170/05)**: see below for a discussion thereof.

132 *Id.* § 45.

4.2.1. Origin-State cases

We know from the foregoing that from an origin-State perspective the Court must assess whether the Member States' "national treatment" is applied to nationals/residents regardless to whether they have or not availed themselves with a fundamental freedom. The fact that "national treatment" is not neutral in that respect amounts in itself to a prohibited restriction.

The reasoning applied by the Court is reflected in the examples that are discussed in brief below.

- *Relief from economic double taxation of inbound dividends.*

In cases such as ***Manninen***[133], ***Lenz***[134], ***Meilicke***[135] and ***FII-Group-Litigation***[136] the Court has found that national taxpayers that invest in national companies and national taxpayers that invest in foreign companies are comparable with regard to domestic provisions aimed at eliminating economic double taxation on dividends paid out by such companies.

For instance, in *Manninem* the Court preliminarily noted that both dividends distributed by a resident company and those distributed by a non-resident company are, apart for the eligibility to the tax advantage at issue,

> "*capable of being subject to double taxation*"[137] .

Thus, having recognized that the purpose of the domestic provision at issue was indeed that of eliminating double taxation it concluded that such provision made

> "*the grant of the tax credit subject to the condition that the dividends be distributed by companies established in Finland, while shareholders fully taxable in Finland find themselves in a comparable situation, whether they receive dividends from companies established in that Member State or from a company established in another Member State*"[138].

- Off-setting of cross-border losses:

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133 Case C-319/02.

134 Case C-315/02.

135 Case C-292/04

136 Case C-446/04.

137 *Manninen*, § 35.

138 *Id.*, §37.

i) Subsidiaries

In *ICI*[139] and *Marks-and-Spencer* (discussed earlier) the Court established comparability between resident parent companies with national subsidiaries and resident parent companies with foreign subsidiaries with respect to domestic group-relief provisions;

ii) Branches

The *Lidl Belgium* case discussed earlier provides an interesting example of the comparative analysis that the Court undertakes in an origin-State environment.

In order to assess whether the national measure at hand was "selective" or, in other words, whether the "national treatment" was or not neutral with respect to the exercise of a fundamental freedom, the Court elected, as the appropriate comparator in light of the purpose of the provision at issue, a "permanent establishment" situated in the same Member State where the principal company had its registered offices[140]. Thus, the ECJ went on to compare the treatment of "domestic branches" and of foreign branches, coming to the conclusion that the differentiation thereof amounted to a restriction on freedom of establishment. The fact that "domestic branches" do not exist as a legal concept in their own merit is irrelevant for the Court: by referring to the tax treatment of "domestic branches" the Court draws the attention to the fact that, in terms of comparability[141], there is no difference between losses suffered in the territory of the Member State where the principal company is resident and losses suffered in other Member States.

- Deductibility of pension contributions

In a line of decisions started off by the ***Bachmann***[142] case and followed by ***Commission v. Belgium***[143], ***Wielockx***[144], ***Danner***[145] and ***Commission v. Denmark***[146]

139 Case C-264/96.

140 *Lidl Belgium* § 24. See above par. 3 of section B for a discussion on the concept of "resident branch".

141 In terms of applicable justifications it may, to the contrary, make a substantial difference: see § 27 and ff.

142 Case C-204/90.

143 Case C-300/90

144 Case C-80/94.

145 Case C-136/00

146 Case C-150/04

the Court dealt with the limitations set by MSs on the deductibility of pension contributions.

These cases are particularly interesting because of, *inter alia*, the fact that the limitations at play hindered two fundamental freedoms at the same time: that is to say freedom to provide services on the part of pension institutions (host-State perspective) and free movement of workers on the part of the insured taxpayers (origin-State perspective).

The Court thus grounded its reasoning on two patterns of comparisons: resident insurers *vis à vis* non-resident insurers, on the one hand, and nationals who pay contributions to resident institutions *vis à vis* to non-resident institutions, on the other hand.

4.2.2. Host-State cases

As discussed above, comparability has a "legal doorway" role in host-State cases: that is to say it determines a (non-resident) taxpayer's eligibility to the "national treatment" of a given Member State; such eligibility being the prerequisite to challenge that treatment on grounds of discrimination.

The following examples, which have in part been dealt with in the previous paragraphs, highlight the relevance that the Court recognizes also in a host-State environment to the purpose of the national provision at play in the main proceeding in order to establish comparability.

- Taking into account taxpayers' overall ability to pay

The milestone conclusion reached in the *Schumacker* decision is that, although as a rule residents and non-residents may be treated differently because they are not in a comparable situation[147], when it comes to taking into account personal and family circumstances (which, together with the aggregate income, form a taxpayer's ability to pay[148]) the position of a resident and the position

> "*of a non-resident who receives the major part of his income and almost all of his family income in a Member State other than that of his residence*"[149]

become comparable and, as a result, the latter is entitled to the "national treatment", that is to say to a not less favourable treatment than that reserved to the former.

147 *Schumacker* § 34.

148 *Id.* § 32.

149 *Id.* § 38.

From a domestic and international tax-law standpoint, it may seem incomprehensible that the source State should be under the obligation to take into account the non-resident's personal and family circumstances given that the non-resident and his family actually live in another country. Yet, inasmuch as:

- according to the host-State "national treatment", resident taxpayers' personal and family circumstances are to be taken into account in determining their overall ability to pay

  and

- the ability to pay of a non-resident (and of his family) is almost all concentrated in that State as a consequence of the fact that he has availed himself with the freedom of movement of workers

the non-resident, with respect to that provision, is comparable to a resident (in fact both of their whole ability to pay is subject to taxation in that State) and, as such, must be granted the "national treatment" at issue.

This approach (for the purpose of assessing the taxpayer's overall ability to pay, a resident is comparable to a non-resident who gains almost all of his ability to pay in the State of employment) has been confirmed in the following jurisprudence.

In particular, in ***Gschwind***[150] the Court held that the host-State is under no obligation to take into account the personal and family circumstances of a non-resident in situations where enough income is gained in the State of residence as to so maintain the possibility of account to be taken of those circumstances in such State[151].

In *De Groot*, the ECJ rehearsed this approach in a situation where the non-resident's total income had been generated in more than two States and the State of residence had accepted the deduction of a maintenance payment only *pari passu* to the percentage (40%) of the income that was taxed in such State according to the relevant DTCs. The Court concluded that it was the obligation of the State of residence, and not of the State(s) of employment, to take into account the whole amount of the payment at issue[152], notwithstanding the fact that it taxed only a fraction of the taxpayer's income[153].

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150 Case C-391/97.

151 *Id.*, § 32.

152 *Id*. § 91.

153 According to B. Terra and P. Wattel, Id., 97 the Court should have held that each host-state in which the worker had gained a fraction of his overall income was obliged to take into account a corresponding fraction of his personal and family circumstances. We submit that such a conclusion would have been out of the Court's reach: indeed -for the purpose of assessing the

Both decisions, as stated above, have come to conclusions (from different perspectives: host-State in *Gschwind* and origin-State in *De Groot*) that confirm the *Schumacker* approach: that is to say that with respect to a national provision whereby personal and family circumstances are taken into consideration for the purpose of charging to tax the overall ability to pay of the taxpayer ("national treatment"), a non-resident that gains almost all of his ability to pay in that State is comparable to a resident and, as such, is entitled to benefit from that fiscal treatment[154].

The *Schumacker* comparability test applies not only in situations where the taxpayer's personal and family circumstances are not taken into account in the Member State of residence because he has not enough income there, but also where he actually earns sufficient income in that Member State for those circumstances to be taken into account but the same is tax exempt, as in the ***Wallentin***[155] case. It is confirmed, therefore, that what the ECJ is concerned with is the fact that -whichever the reason may be- the non-resident's "taxable" ability to pay is concentrated in the host-State; this entails his comparability to residents and, as a result, his entitlement to "national treatment" with respect to tax advantages having the purpose of taking into account the taxpayer's overall ability to pay.

The Court, in the cases that we have so far referred to, was concerned with "personal and family circumstances": the idea being that inasmuch as a Member State takes those circumstances into consideration for the purpose of assessing (and thereby charging to tax) the total income of residents, that Member State must also extend that "national treatment" to non-residents that are comparable thereto for having gained their total income in that State.

In later cases (such as ***Ritter-Coulais***[156], ***Lakebrink***[157] and ***Renneberg***[158]) the same approach is applied to situations where non-residents -who earned all (or almost all) of their income in the State of employment (and therefore satisfied the *Schumacker* test)- applied for "negative income" deriving from immovable property owned in the State of residence to be taken into account for tax purposes in the former State.

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overall ability to pay of a taxpayer- a worker that earns only a fraction of his income in the host-state is not comparable to a resident of that State and, as such, in not entitled to access to that particular "national treatment".

154 See also ***Zurstrassen* (Case C-87/99**) § 21. Although for different purposes than those at the origin of the cases so far analyzed, the *Schumacker* legacy can be seen at play also in ***Gerritse* (Case C- 234/01)**, § 43.

155 Case C-169/03.

156 Case C-152/03.

157 Case C-182/06.

158 Case C-527/06.

The step forward made by the Court in its understanding of the ramifications of the *Schumacker* doctrine is essentially that the obligation of the State of employment to extend the appropriate "national treatment" to comparable non-residents applies notwithstanding the fact that the relevant "circumstances" to be taken into account for tax purposes in that State consist of "negative income", that is to say of a loss deriving from a source of income (immovable property in the situations at hand).

This expansion of the *Schumacker* doctrine's scope has been criticized on the grounds that "negative income" from immovable property should not stay under the same roof with "personal and family circumstances" as referred to in the *Schumacker* case[159].

The Court, under the guidance of AG Léger[160] and Mengozzi[161], actually addressed this issue itself (attraction of negative income under the concept of personal and family circumstances) essentially stating that according to the *Schumacker* criterion discrimination concerns

> "*all the tax advantages connected with the non-resident's ability to pay which are not taken into account either in the State of residence or in the State of employment, since the ability to pay tax may indeed be regarded as forming part of the personal situation of the non-resident within the meaning of the judgment in Schumacker*"[162].

This finding, although not completely accurate on all accounts, is in my opinion absolutely right in its substance.

The inaccuracy derives from the fact that -contrary to the statements laid down in *Ritter-Coulais* and in *Lakebrink*- in the *Schumacker* judgement it was never held that the non-resident's ability to pay forms part of his personal situation; indeed, the Court said the opposite, that is to say that the "non-resident's ability to pay [is] determined by reference to his aggregate income and his personal and family

159 According to G. T. K. Meussen, *An Analysis of the Dutch AG's Opinion on Renneberg,* 2009 WTD 91-9, "…the taxation of a personal dwelling is a source-related item of income that should not fall under the 'personal and family circumstances' that are the constituting factors of *Schumacker*. It seems incomprehensible that the Netherlands is forced by this ruling to provide a tax incentive for a personal dwelling to a Belgian resident because he happens to work in the Netherlands". See also: the opinion of P. Wattel (AG to the Dutch Supreme Court) handed down on February 10, 2009; G. Meussen, *The Ritter-Caulais Case – A Wrong Decision in Principle by the ECJ,* European Taxation, 2006, 335 ff.

160 Opinion in *Ritter-Coulais,* points 97 to 99.

161 Opinion in *Lakebrink,* point 36.

162 *Lakebrink,* § 34 and *Renneberg* § 63

circumstances"[163] (which, in any event, makes much more sense than the other way round).

Having said this, the Court's reasoning is nevertheless persuasive: inasmuch as residents and non-residents may, under certain conditions, be regarded as comparable for the purpose of taking into account their personal and family

circumstances, the same conclusion should be reached for the purpose of taking into account their overall ability to pay. In fact there are no such differences between the two concepts to justify the finding that there should be no comparability with respect to the taking into account of the taxpayers ability to pay (and thus also of his "negative income").

The Court, in the cases at hand, is therefore doing nothing more than correctly applying the "national treatment" principle that has always underpinned its jurisprudence on the fundamental rights. Indeed, in each of the decisions we have gone through, the ECJ has always been careful to clearly state that the fiscal treatment which was denied to the non-resident was actually part of the appropriate "national treatment" applicable to residents[164].

Once the foregoing facts were recognized, the *Schumacker* doctrine (residents and non-residents who receive almost all their income in State of employment are comparable) left no other choice to the Court -lacking any acceptable justification- than that of extending to the latter the relevant "national treatment" that the Member State had withheld in violation of EC law.

Consistently to its case law, the ECJ is therefore by no means interfering with Member States' willingness to take (or not take) into account for tax purposes (say) taxpayer's personal and family circumstances or (say) "negative income" deriving from immovable properties; it is only assuring that inasmuch as those measures are actually laid down (and thus form part of a Member State's "national treatment"), they are made available both to residents[165] and non-residents[166] who have not

163 *Schumacker*, § 32. See also § 33 where the Court notes that "*The situation of a resident is different* [vis à vis to a non-resident] *in so far as the major part of his income is normally concentrated in the State of residence. Moreover, that State generally has available all the information needed to assess the taxpayer's overall ability to pay, taking account of his personal and family circumstances*".

164 See *Ritter-Coulais* § 37, *Lakebrink* § 13 and *Renneberg* § 58.

165 Whether origin-State.

166 Whether host-State.

exercised the fundamental freedoms and to comparable residents and non-residents who have availed themselves with those freedoms[167].

- Extending (domestic law or DTC) tax advantages to branches of non-resident companies

In *Avoir-fiscal* the host-State rule's purpose was to avoid economic double taxation of dividends by granting a tax credit to the recipient: such credit was denied to branches of companies having their registered office in another Member State.

The Court held that inasmuch as dividends received by those branches and dividends received by resident companies were taxed in same manner[168], any advantage related to such taxation had to be granted to both[169].

Also the following *Saint-Gobain* case was originated by an unfavourable treatment of branches *vis à vis* resident companies: the host-State refused to extend to the former certain concessions (provided for in two DTCs with third countries) in relation to the taxation of shareholding in third countries' subsidiaries and of the dividends they generated.

Similarly, the Court noted that from the point of view of the *purpose* of the provisions in question - that is to say, to regulate the liability to taxation of those dividends and shareholdings - the resident company and the non resident company were in "objectively comparable situations" [170]; therefore, it predictably concluded, they had to be treated in the same way when it came to the tax concessions.

The *Commerzbank*[171] and *Royal Bank of Scotland*[172] cases are further instances of the company-branch comparability in light of the purposes of the respective national provisions concerned.

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167 As persuasively noted by T. O'Shea, *Dutch Rental Income Loss Rules Incompatible With Free Movement Of Workers, ECJ Says,* 2008 WTD 248, "*If the Netherlands did not provide such a tax advantage for its own residents, then it would not have to grant them in situations like Renneberg's*".

168 *Avoir Fiscal,* §19.

169 *Id.,* §20.

170 *Saint Gobain,* §47-48.

171 Case C-330/91.

172 Case C-311/97.

- Relief from economic double taxation of outbound dividends.

The crucial role played by the purpose of the national provision in the Court's understanding of the concept of comparability is further highlighted in cases as ***Denkavit-International***[173], *ACT-IV-Group-Litigation* and more recently ***Aberdeen Property Fininvest Apha OY***[174] where the similarity was established among dividends received by non-resident shareholders and dividends received by resident shareholders with reference to a provision aimed at preventing economic double taxation on the former dividends (this may described as the "mirror situation" to that of the origin-State taxation of inbound dividends analysed above).

The Court concluded that if the Member State where the distributing company is resident:

i) taxes, unilaterally or by DTC, dividends paid out to non-residents and;

ii) lays down measures to prevent or mitigate economic double taxation on dividends paid to residents,

such Member State is under the obligation to apply such measures indiscriminately because, to the extent that both categories of dividends are liable to double taxation in such jurisdiction, they are then comparable on such grounds[175].

In other words, comparability is here triggered by the fact that economic double taxation is a wholly source-State matter *non only* when the dividends are received by a resident *but also* when they are received by a non-resident and this entails that the latter is entitled to not less favourable treatment in that respect.

4.3. Tax disadvantages

At paragraph 4.1 of section C we have submitted that the purpose of tax disadvantages tends to be more self-evidently aimed at targeting cross-border situations[176] and, as a result, comparability is more easy to establish: the examples discussed below may confirm that hypothesis.

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173 Case C-170/05.

174 Case C- 303/07.

175 *Denkavit International* §35, *ACT-IV-Group-Litigation* §68, *Aberdeen Property Fininvest Apha OY* § 43

176 Whereas tax advantages' purpose is often devoid of "cross-border motivations".

4.3.1. Origin-State cases

Disadvantages on international groups

The *Cadbury Schweppes* case is an excellent example of the foregoing point.

At the outset the Court pointed out that

> "*in this case it is common ground that the legislation on Controlled Foreign Companies involves a difference in the treatment of resident companies on the basis of the level of taxation imposed on the company in which they have a controlling holding*"[177]

and then went on to the foregone conclusion whereby

> "*that difference in treatment creates a tax disadvantage for the resident company which the legislation on CFCs is applicable*"[178].

Differently to (say) *Marks & Spencer*, where the tax advantage's purpose was not - in itself - to grant parent companies with resident subsidiaries a competitive advantage *vis à vis* parent companies with non-resident subsidiaries, in *Cadbury Schweppes* the tax disadvantage's purpose was actually that of treating in a "worse-off manner" parent companies with non-resident subsidiaries which were subject to a "lower level of taxation"[179].

It follows that, in this second instance, comparability between the situations at play and restrictiveness of the measure were, to a large extent, self-evident.

This case is also relevant with respect to the submission we have made at paragraph 3.7 of section B. The ascertainment of the selectiveness of a tax provision (*id est*: the different treatment of comparable situations) is the object of a "first stage" assessment not only where host-State provisions are at play. Where, as in *Cadbury Schweppes*, the Court finds that there is a "*difference in treatment*"[180] there is no need for an additional analysis on the restrictiveness of the national provision; to the contrary, where it finds that that provision is not selective, as for instance in

177 *Cadbury Schweppes* § 43.

178 *Id.* § 45

179 *Ibidem.* In particular, whereas parent companies with UK subsidiaries (or with non-resident subsidiaries which were not subject to a "lower level of taxation") were not taxed on the profits of their subsidiaries, parent companies with non-resident subsidiaries which were subject to a "lower level of taxation" were taxed on the profits of their subsidiaries.

180 *Ibidem*

Deutsche Schell, it embarks on a "second stage" assessment to ascertain whether the (non selective) provision is all the same restrictive.

The *Cadbury Schweppes'*s pattern of reasoning underpinned also the earlier decision in the ***Bosal Holding***[181] case and the subsequent decision in the ***Thin-Cap-Group-Litigation*** case[182].

In *Bosal Holding* the national provision at play limited the deductibility of financial costs incurred in connection with the capital of subsidiaries. Having noted that such a provision affected mainly companies investing in non-resident subsidiaries[183], the Court went straight to the conclusion that such a disadvantage amounted to a prohibited restriction on freedom of establishment[184].

In the *Thin-Cap-Group-Litigation* case (UK) national provisions -in some circumstances- re-characterized infra-group (deductible) interest paid to related non-resident companies as (non deductible) dividends. The Court held first of all that such provisions

> "*give rise to a different treatment between resident borrowing companies according to whether or not the related lending company is established in the United Kingdom*".

According to the Member State's defence, however, that different treatment did not actually amount to a restriction because

> "*the position of multinational group of companies is not comparable to that of a group of companies, each of which is resident in the same Member State*"[185].

The Court dismissed this argument because it did not accept the comparison it was based upon: comparability had not to be established between domestic and international groups (which the Court acknowledged are not comparable from a tax perspective) but between resident subsidiaries according to whether their parent

181 Case C-168/01

182 Case C-524/04.

183 The limitation actually applied only to costs that were not, even indirectly, "*instrumental in making profits which are taxable in the MS where the parent company is established*" (§ 12). However, the Court noted that, in factual terms, that tax disadvantage would mainly affect costs related to non-resident subsidiaries' given that "*normally, such subsidiaries, do not generate profits that are taxable*" in the MS where the parent company has its registered offices (§ 27).

184 *Id.* 27

185 *Thin-Cap-Group-Litigation*, § 58-60.

company was or was not resident in the same Member State [186]. In other words, to the extent that the alleged restriction impacted at the level of subsidiaries, it was at that level that such restriction had to be assessed.

Having disposed of the comparability issue, the ECJ was instantly drawn to the conclusion that the "*difference in treatment* (...) *constitutes a restriction on freedom of establishment*"[187]

- "Exit taxes"

A crucial area of tax disadvantages the compatibility of which has been tested before the ECJ is that of "exit-taxes", that is to say of taxes that Member States levy upon the migration of its nationals to other Member States.

In the ***Lasteyrie-du-Saillant***[188] case (as in the subsequent ***N. v. Inspecteur***[189] case) the Court was concerned with a national provision whereby a taxpayer who transferred his tax residence to another Member State was, under certain conditions, charged to tax on the latent increases in value of shares held by the same.

The Court found that the situation of a taxpayer who transfers his tax residence outside the territory of a Member State and the situation of a taxpayer who maintains his tax residence in that Member State are comparable; as a result a provision that imposes a disadvantageous treatment on the former may amount to a restriction on fundamental freedoms[190].

Interestingly the Court -as if not totally certain of the soundness of such comparison- embarked on the "second stage" assessment that it usually carries out only where it finds that the provision under analysis is not selective (because of the non comparability of the situations at play or because that national provision is "even handed"). In particular, notwithstanding the fact that it had found that the national provision treated differently (and worse off) comparable situations, which would normally be a self-sufficient ground for regarding such provision as restrictive, the Court nevertheless went on to analyse its actual hindrance on taxpayers' fundamental freedoms (in light of the measures according to which the "exit tax"

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186 *Id*, § 60.

187 *Id.* § 63.

188 Case C-9/02.

189 Case C-470/04. The decision confirmed the findings of the decision in *Lasteyrie-du-Saillant* as far as the comparability issue is concerned.

190 *Id*. § 46.

was collected) and came to the conclusion that such analysis "confirmed" the restrictive effect of the treatment at play[191].

- "Add backs" to trade earnings

A further example of a tax disadvantage imposed in an origin-State environment is provided by the ***Eurowings***[192] case.

The case originated by a national provision whereby resident recipients of lease services were requested to make certain add-backs where the provider of such services was not subject to trade tax on its earnings. As a result, those add-backs were imposed as a rule whenever the service provider was a non-resident undertaking.

In order to object against the claimant's complaint that lessees receiving services from resident lessors (no add-back imposed) were afforded more favourable treatment than lessees receiving services from non-resident lessors (add-back imposed), the Member State argued that the two situations were not comparable

under the following argument: whereas "*a lessor established in another Member State might be able to charge the lessee a lower rental because he is not liable to trade tax*", a resident lessor would pass the trade tax he is liable to on to the lessee by incorporating it in the rental[193]. In other words, according to that argument, the add-backs equalized the two different situations by offsetting the "advantage" that non-resident lessors and resident lessees enjoyed by virtue of the fact that cross-border leases were not affected by trade tax[194].

In that respect the court essentially held that any tax advantage enjoyed by a non-resident taxpayer is not, in itself, an element which may be taken into account in the assessment of his comparability to a resident taxpayer[195] and it concluded that any tax arrangement devised to compensate such advantages "*prejudice the very foundation of the single market*"[196].

191 *Id.* §47-48. It could have been argued that, having regard to the purpose of the national provision at play, the two situations were not comparable: indeed, whereas the transfer or residence impacts on a MS's tax jurisdiction, maintaining it has no such a consequence. At that point the Court could have held that the measure was even so restrictive because it constituted an obstacle to the exercise of the freedom of establishment and thereinafter focus on the applicability of justifications.

192 Case C-297/97.

193 *Id.* § 29.

194 *Id.* § 30.

195 *Id.* §44..

196 *Id.* §45.

4.3.2. Host-State cases

- Limitations to the deduction of business expenses and acquisition costs

In ***Gerritse***[197] the Court made the point that, as a general rule, where a Member State (Germany in this case) taxes resident providers of services on a "net basis" (that is to say admitting the deduction of business expenses) it is prevented from taxing on a "gross basis" non-residents who pursue the same activities in its territory[198].

The Court came to that conclusion through the usual reasoning based on "national treatment" and comparability.

As for the "national treatment" syllogism, the ECJ pointed out that insofar as residents of a MS are taxed on their net income after deduction of operating expenses that have a direct connection to the activity they carry out, such expenses should in principle be taken into account also with regard to non-residents pursuing an activity in that Member State.

Then the Court went on to examine comparability noting that for the purposes of taking into account "operating expenses which have a direct connection to the activity pursued", residents and non-residents are placed in a comparable situation. In other words

> "*... the business expenses in question are directly linked to the activity that generated the taxable income in Germany, so that residents and non-residents are placed in a comparable situation in that respect*"[199].

The subsequent decision in ***Scorpio***[200] confirmed that resident and non-resident providers of services are comparable for the purpose of taking into account - in determining their respective taxable base - costs that are directly linked to the activity carried out in the territory of the host-State[201].

Furthermore, the Court found that the same are comparable also with respect to the means that the host-State may adopt for the purpose of "ensuring" the taxation of the income derived from the activity in question, that is to say to assess and actually collect the tax due by service providers[202]. However, the ECJ maintained as well that

197 Case C-234/01.

198 *Id.* § 28.

199 *Id.* § 27.

200 Case C-290/04.

201 *Id.* § 49.

202 *Id.* § 34.

a measure such as a retention at source of the tax due by the non-resident (in the absence of mutual administrative assistance instruments concerning the recovery of tax debts between the two Member States at play) may be a "legitimate", "appropriate" and "justified" mean to achieve the foregoing[203]; provided, nevertheless, that such a method does not impede the taking into account of the expenses incurred in by the non-resident provider of services[204].

The ***Centro Equestre***[205] decision corroborated the comparability assessment onto which the Court based its case law in this area pointing out that for the purposes of satisfying the "directly linked costs" test, "*the place and time at which the costs were incurred are immaterial*"[206].

The ***Bouanich*** case[207] follows this same line of reasoning with regard to a host-State provision that differentiated the tax treatment of income received upon a share repurchase according to whether the recipient was a resident or a non-resident. In particular, whereas the former's income was characterized as a capital gain determined by deducting the cost of acquisition from the share repurchase payment, the latter was characterized as a dividend and the share repurchase payment was thus charged to tax without deducting the cost of acquisition.

The Court was able to concentrate in two sentences the "national treatment" and comparability assessments:

> "*...the cost of acquisition is directly linked to the payment made on occasion of a share repurchase so that, in this regard, residents and non-residents are in comparable situations. There is no objective difference between the two situations such a to justify different treatment on this point between the two categories of taxpayers*"[208]

The ECJ had then to examine whether the restriction entailed by the tax treatment at play might be "healed" by the DTC in place between the host-State and the Member State of residence of the compliant: the Court concluded that in principle a DTC may have such an effect, subject to a factual assessment thereof by the national court[209].

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203 *Id.* § 36-37.I

204 *Id.* § 49.

205 Case C-345/04.

206 *Id.* § 23.

207 Case C-265/04.

208 *Id.* § 40.

209 *Id.* § 53.

In *Truck Center*[210], a case we have above referred to because of the "two stages" (discrimination and restriction) assessment it features[211], the Court came to the conclusion that resident and non-resident parent companies are not comparable with respect to the taxation of loan interest received by a resident subsidiary. The national provision differentiated the treatment of the two situations: whereas interest paid to non-resident recipients were taxed by means of a withholding tax levied on the gross amount of the payment, interest paid to resident recipients were subject to corporation tax after deduction of costs. Having found no comparability the Court held that the treatment was not discriminatory and went on to examine whether it, even so, entailed a restriction on freedom of establishment.

The Court has put forward three reasons to justify its conclusion on comparability:

i) The first is that the host-State act in two different capacities when it taxes interest paid out to a resident company or to a non-resident company: in the first case it acts in its capacity as the State of residence, whereas in the second as the State of source[212];

ii) The second is that "the payment of interest by one resident company to another resident company and the payment of interest by a resident company to a non-resident company give rise to two distinct charges which rest on separate legal bases": the first being domestic law and the second DTC-law[213];

iii) The third is that the resident and the non-resident company find themselves in different situation with regard to recovery of tax[214].

- Measures aimed at counterbalancing non-residents' tax advantages

In *Asscher* the host-State (the Netherlands) applied different treatment of resident and non-resident self-employed workers: the former were taxed on their income in first band at a 13% rate, the latter at a 25% rate. The purpose of the unfavourable host-State provision was

210 Case C-282/07.

211 Paragraph 3.4. of section B.

212 Truck Center, § 42.

213 *Id.,* § 43.

214 *Id*, § 47.

> "*to offset the fact that certain non-residents escape the progressive nature of the tax because their tax obligations are confined to income received in the Netherlands*"[215].

This decision is extremely interesting because, *inter alia,* of the clear use that the Court makes of the purpose of the national provision in order to assess comparability between the situations at play.

The Member State's argument here was that non-residents and residents were non comparable because of the fact that the former escaped progressivity on their foreign income.

On the contrary, the Court found that by virtue of the DTC in place between the host-State and the State of residence the latter, whereas exempting the foreign income of resident taxpayers, it nevertheless took the same into account for the purpose of determining the appropriate tax rate ("exemption with progression") applicable to domestic income.

It followed that

> "*The fact that a taxpayer is a non-resident thus does not enable him, in the circumstances under consideration, to escape the application of the rule of progressivity. Both categories of taxpayers are therefore in comparable situations with regard to that rule*"[216].

5. Conclusions

Member States are essentially free to tailor their national fiscal systems as they please by determining *who* or *what* should be taxed, irrespective of whether the selected taxable event falls within one or two jurisdictions; however, once that choice has been made, the (respectively, national or international) tax provisions through which those choices are actually translated into taxes levied must be compatible with the Treaty freedoms[217].

To that end, a crucial instrument for interpreting the impact of the limits entailed by Treaty compliance is the consideration of the *purpose* of the national provisions that interfere with the cross-border dimension of tax liability: such a notion is in fact key to establishing comparability with respect to allegedly restrictive provisions.

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215 *Asscher* § 46.

216 *Id.* § 48.

217 As AG Maduro points out at § 28 of its opinion in *Marks & Spencer,* restriction "*is therefore a matter of pursuing discrimination against Community nationals wishing to assert their rights derived from the freedoms of movement*".

The ECJ has consistently referred to that aspect of the domestic legislation at issue, thereby conferring methodological uniformity to its jurisprudence.

Furthermore, a teleological approach to the understanding of comparability seems the only viable one in the perduring absence of Community Law intervention in the direct tax area: indeed, through that approach, the Court is able to enforce Member States' compliance to the Treaty whilst being, in its turn, compliant to Member States' tax sovereignty and to tax policies they pursue through their legislation.

To state that the ECJ is by no means interested in the rationales of domestic taxation as such (inasmuch as competence in direct taxation is still with the Member States) but only in its ramifications *vis à vis* the exercise of fundamental freedoms may be regarded as a trivial remark, yet it addresses a crucial feature of the ECJ's understanding of its own role.

To this effect, we have seen that the Court sees no violation of fundamental freedoms in disparities (see for instance *Deutsche Shell* § 43[218]) or in the juridical double taxation that follows the exercise in parallel of Member States' tax jurisdictions (see for instance *Block* and *Damseaux*[219]).

Moreover, as a further instance of the aforementioned lack of concern for direct taxation insofar as it does not hinder the exercise of fundamental freedoms, we have seen that the Court is neither interested in economic double taxation as an issue in its own merit; yet, once a Member State provides for an economic double taxation relief with respect to outbound[220] or inbound[221] dividends, the ECJ expects such a tax advantage (the "national treatment") to be extended to the appropriate comparable situation[222].

Should the UK or Finland[223] not have introduced measures to eliminate economic double taxation on dividends paid out respectively *to* resident shareholders or *by* resident companies (the "national treatment"), it would not have had to extend them to comparable situations in which the rights of establishment and of free movement of capitals had been exercised.

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218 Paragraph 2 of the section A

219 *Idem.*

220 See *ACT IV Group Litigation*.

221 See *Mannimen*.

222 With reference to outbound dividends the obligation of the host-State to extend a measure devised to eliminate economic double taxation to dividends paid out to non-resident shareholders presupposes that those dividends are taxed by the Member State in question.

223 See the last two footnotes above.

The same may be said for the offsetting of subsidiaries' losses[224] and for many other "tax advantages" made available to residents that the Court has become concerned with *only once and to the extent* that they were proved to be inaccessible to comparable non-residents (in host-State cases) or fellow residents that had availed themselves with the fundamental rights (in origin-State case).

What has just been noted with reference to "tax advantages" is also true for "tax disadvantages", when they are applicable only to non-residents (in host-State cases)[225] or to fellow residents (in origin-State cases)[226] that avail themselves with the fundamental rights.

However, cases such as *Futura* and *Truck Center* teach that the Court expects Member States not only to apply the relevant "national treatment" to comparable situations, but also in any event to refrain themselves from restricting through taxation the exercise of fundamental freedoms[227].

In conclusion, the Court leaves direct taxation to Member States insofar as it is neutral with respect to fundamental freedoms: to the extent that the "national treatment" is neutral -meaning that it doesn't restrict the exercise of the fundamental freedoms- there is no room for the Court to take action.

To this effect comparability plays a crucial role:

- in a host State setting it constitutes the "legal doorway" through which a non-national may access to a Member State's "national treatment"[228];

- in an origin-State setting it constitutes the "first stage" assessment through which the Court ascertains whether a Member State is or not hindering the exercise of fundamental freedoms by its own nationals[229].

Our analysis has put in evidence:

- the different level of complexity of that "first stage" assessment (whether the situations are comparable and the national treatment is "selective") *vis à*

224 See *Marks and Spencer*.

225 As in *Asscher* § 42.

226 As in *Cadbury Schweppes*.

227 See Paragraph 3.2.3. of section B.

228 See Paragraph 2.1.1 of section C.

229 See Paragraph 3 of section C-

vis the "second stage" assessment (whether the "national treatment" is restrictive even if "not selective")[230];

- the different complexity of the comparability assessment according to whether a tax advantage or a tax-disadvantage is at play in the main proceeding[231].

It would be wrong, however, to deny that Member States' freedom in direct taxation is not greatly reduced by the obligation to grant "national treatment" and to make sure that such treatment does not amount in any event to a hindrance to the exercise of fundamental freedoms. In fact, insofar as they:

- "afford" a tax advantage domestically (say: dividend tax credit, group relief, deduction for personal and family circumstances),

  or

- "impose" a tax disadvantage cross-border (say: a limitation on the deduction of costs, a higher tax rate etc.)

they have to extend it to respectively domestic or cross-border comparable situations unless they can claim that failure to do so is justified under the rule of reason.

230 See Paragraph 3 of section C.

231 See Paragraph 4.1. of section C.